

**Box 4****PRIVATE SECTOR EXPECTATIONS FOR THE EURO AREA: RESULTS OF THE ECB SURVEY OF PROFESSIONAL FORECASTERS FOR THE FIRST QUARTER OF 2006**

This box reports the results of the 30th ECB Survey of Professional Forecasters (SPF), conducted between 19 and 23 January 2006.<sup>1</sup> The SPF gathers expectations for euro area inflation, economic activity and unemployment from experts affiliated to financial and 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 indicators of private sector expectations for the same horizons.

**Inflation expectations for 2006 and 2007**

Inflation expectations for 2006 have remained at 2.0%, as in the previous SPF. This reflects only slight revisions to the assumptions and still implies that broadly stable oil prices are expected, albeit at relatively high levels, as well as moderate wage developments and broadly stable growth dynamics. By contrast, inflation expectations for 2007 have been revised upwards from the 2005 Q4 SPF, by 0.2 percentage point to 2.0%. A strong majority of respondents

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

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon				
	Dec. 2006	2006	Dec. 2007	2007	Longer term <sup>2)</sup>
2006 Q1 SPF	1.9	2.0	1.9	2.0	1.9
<i>Previous SPF (2005 Q4)</i>	-	2.0	-	1.8	1.9
Consensus Economics (Jan. 2006)	-	2.0	-	2.0	1.9
Euro Zone Barometer (Jan. 2006)	-	2.0	-	2.0	1.9
Real GDP growth	2006 Q3	2006	2007 Q3	2007	Longer term <sup>2)</sup>
2006 Q1 SPF	1.9	2.0	1.9	1.9	2.1
<i>Previous SPF (2005 Q4)</i>	-	1.7	-	2.0	2.1
Consensus Economics (Jan. 2006)	-	1.9	-	1.8	1.9
Euro Zone Barometer (Jan. 2006)	-	1.9	-	1.7	1.8
Unemployment rate <sup>1)</sup>	Nov. 2006	2006	Nov. 2007	2007	Longer term <sup>2)</sup>
2006 Q1 SPF	8.1	8.2	7.8	8.0	7.2
<i>Previous SPF (2005 Q4)</i>	-	8.5	-	8.2	7.5
Consensus Economics (Jan. 2006)	-	8.3	-	8.1	-
Euro Zone Barometer (Jan. 2006)	-	8.3	-	8.2	7.6

1) As a percentage of the labour force.

2) In the current and previous SPF rounds and in the Euro Zone Barometer, longer-term expectations refer to 2010. The Consensus Economics forecast refers to the period 2011-15 (data published in the October 2005 Consensus Economics Survey).

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

justified this upward revision on the basis of the planned VAT increase in Germany as of January 2007. As a result, the SPF average forecasts for HICP inflation in 2006 and 2007 are in line with those from both Consensus Economics and the Euro Zone Barometer published in mid-January (see table).

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 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. Several references were made by SPF forecasters in January 2006 to oil prices as a source of upward risk to the inflation outlook. At the same time, the probability distribution of inflation for 2006 from the latest SPF indicates a further upside shift in the risks (see Chart A). SPF respondents now believe that there is a 49% probability that inflation in 2006 may stand between 2.0% and 2.4% (compared with a 44% probability in the previous round). As regards 2007, the probability of inflation in this range is now seen to be 40%, compared with 30% in the 2005 Q4 SPF.

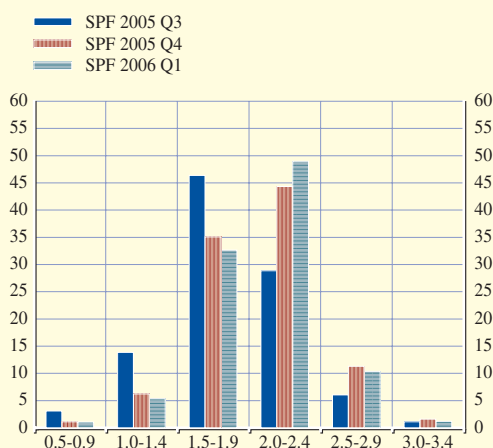
### Indicators of longer-term inflation expectations

Inflation expectations five years ahead have remained unchanged, at 1.9%, for the 17th consecutive round, in line with the recently published estimates from Consensus Economics and the Euro Zone Barometer. However, as shown in Chart B, the probability that inflation five years ahead stands at or above 2.0% rose slightly in the first quarter of 2006, pointing to a small increase in the perception of upward risks to long-term inflation.

SPF survey results can also be compared with the so-called “break-even inflation rate”, an indicator of long-term inflation expectations among market participants (calculated as the yield spread between nominal and inflation-linked bonds). The break-even inflation rates derived

**Chart A Probability distribution for average inflation in 2006 in the last three rounds of the SPF <sup>1)</sup>**

(percentages)



1) Corresponds to the aggregation of each individual probability distribution provided by SPF forecasters.

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

(percentages)



from the French government inflation-linked bonds (linked to the euro area HICP excluding tobacco) maturing in 2012 and 2015 have both remained broadly stable since October 2005 (see Chart C).<sup>2</sup> However, break-even inflation rates should not be interpreted as direct measures of inflation expectations as they may also incorporate various risk premia (such as inflation uncertainty and liquidity premia). Consequently, their level and development may partly reflect uncertainty among investors about future inflation and a resulting willingness to pay a premium for a hedge.

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

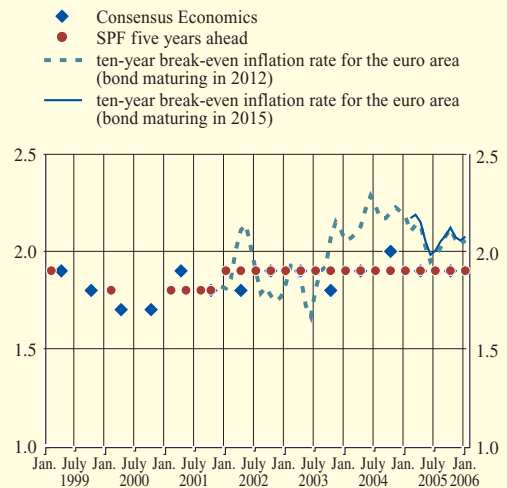
SPF forecasters have, since October 2005, revised upwards their expectations for real GDP growth in 2006 by 0.3 percentage point to 2.0%. This upward revision mainly reflects improved expectations for domestic demand, in part associated with improving labour market conditions that should support stronger consumption growth. According to several respondents, in the second half of 2006 consumption growth should also benefit from spending brought forward by consumers ahead of the planned VAT increase in Germany in January 2007. However, the latter factor is expected to have a dampening effect on growth in 2007, which largely explains the slight downward revision (by 0.1 percentage point to 1.9%) for that year in the latest survey. The main downward risks for the outlook for real GDP growth in 2006 are still assessed to be represented by oil prices and a renewed appreciation of the euro. Upward risks to real GDP growth are also mentioned, as favourable financing conditions, price stability and improvements in profitability are seen as key factors likely to support an upswing in investment. Longer-term growth expectations (five years ahead) are unchanged at 2.1%. The SPF forecasts for real GDP growth are slightly more optimistic than those reported most recently by Consensus Economics and the Euro Zone Barometer across all time horizons considered (see table).

Unemployment rate expectations have been revised downwards for all forecast horizons. The unemployment rate is now expected to stand at 8.2% in 2006 and 8.0% in 2007. The main factors mentioned to account for this decline are stronger growth in the short term and the impact of recent labour market reforms, both in the short and long run, in some countries. However, the revisions to the average point estimates are also explained by statistical revisions to the unemployment data in recent months. The expected rate of unemployment in 2010 now stands at 7.2%, but it is assessed to be very uncertain and conditional on further labour market reforms.

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.

**Chart C Indicators of long-term inflation expectations**

(average annual percentage changes)



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