

Box 3

RESULTS OF THE ECB SURVEY OF PROFESSIONAL FORECASTERS FOR THE SECOND QUARTER OF 2006

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the second quarter of 2006, conducted between 20 and 26 April 2006. The SPF gathers information on 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.

Inflation expectations for 2006 and 2007

SPF forecasters revised their short-term inflation expectations upwards compared with the previous survey conducted in January 2006. Average annual HICP inflation is now expected to stand at 2.1% in both 2006 and 2007, 0.1 percentage point higher than in the previous SPF. Many survey respondents cited recent developments in oil prices and their impact on domestic prices as the main reason for this upward revision. SPF inflation expectations for 2006 and 2007 are slightly higher than the estimates from both Consensus Economics and the Euro Zone Barometer published in mid-April 2006, which were at 2.0% (see table).

SPF participants were 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. Chart A, which shows the aggregate probability distributions for average annual rates of HICP inflation in 2006 in the last three survey rounds, points to a further upward shift in the risks in the most recent SPF round. The probability that inflation may stand between 2.0% and 2.4% is now more than twice that of inflation standing between 1.5% and 1.9%.¹ According to participants' qualitative responses, future oil prices are the main source of upward risks. However, contained wage growth, exchange rate developments and further downward pressure from globalisation are seen as limiting the upside risks to inflation.

¹ Additional data are available on the ECB's website at www.ecb.int/stats/prices/indic/forecast/html/index.en.html.

Results from the SPF, Consensus Economics and Euro Zone Barometer

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon				
	Mar. 2007	2006	Mar. 2008	2007	Longer-term ²⁾
Q2 2006 SPF	2.1	2.1	1.9	2.1	1.9
Previous SPF (Q1 2006)	-	2.0	-	2.0	1.9
Consensus Economics (Apr. 2006)	-	2.0	-	2.0	1.9
Euro Zone Barometer (Apr. 2006)	-	2.0	-	2.0	1.8
Real GDP growth	Q4 2006	2006	Q4 2007	2007	Longer-term ²⁾
Q2 2006 SPF	2.2	2.1	1.8	1.9	2.1
Previous SPF (Q1 2006)	-	2.0	-	1.9	2.1
Consensus Economics (Apr. 2006)	-	2.0	-	1.8	1.9
Euro Zone Barometer (Apr. 2006)	-	2.0	-	1.8	1.9
Unemployment rate ¹⁾	Feb. 2007	2006	Feb. 2008	2007	Longer-term ²⁾
Q2 2006 SPF	8.0	8.1	7.7	7.9	7.2
Previous SPF (Q1 2006)	-	8.2	-	8.0	7.2
Consensus Economics (Apr. 2006)	-	8.2	-	8.0	-
Euro Zone Barometer (Apr. 2006)	-	8.2	-	8.0	7.5

1) As a percentage of the labour force.

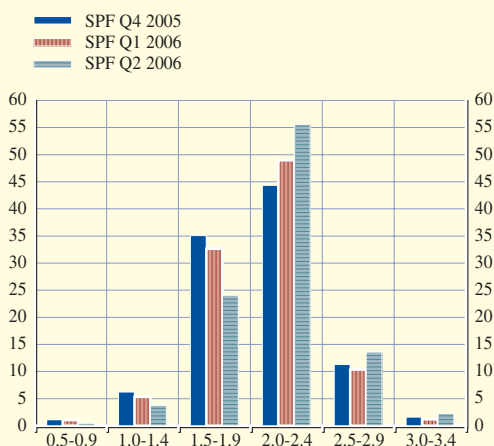
2) In the current and the previous SPF rounds and in the Euro Zone Barometer, longer-term expectations refer to 2010. The Consensus Economics forecast refers to the period 2012-16 (data published in the April 2006 Consensus Economics Survey).

Indicators of longer-term inflation expectations

Longer-term inflation expectations (for 2010) remained unchanged at 1.9% for the 18th consecutive SPF round. These expectations are in line with the latest published estimate from Consensus Economics for six to ten years ahead, but slightly higher than those for 2010 from the April 2006 Euro Zone Barometer. The unchanged mean of the point estimates of 1.9% since

Chart A Probability distribution for average inflation in 2006 in the last three rounds of the SPF ¹⁾

(percentages)

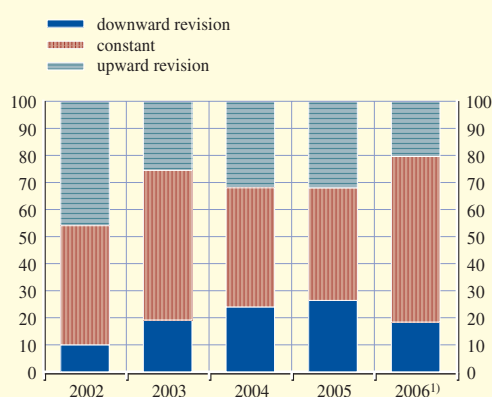


Source: ECB calculations.

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

Chart B SPF forecasters and their revisions to long-term inflation expectations from one year to the next

(percentage share)



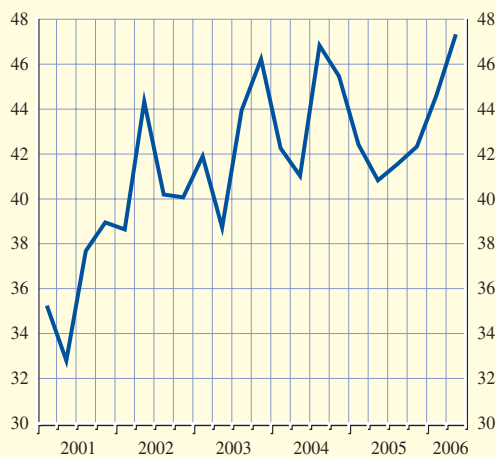
Source: ECB calculations.

Note: For the calculation, annual averages of long-term inflation expectations of individual forecasters are compared for two consecutive years.

1) Refers to the first half of 2006.

Chart C Probability of inflation five years ahead being at or above 2%

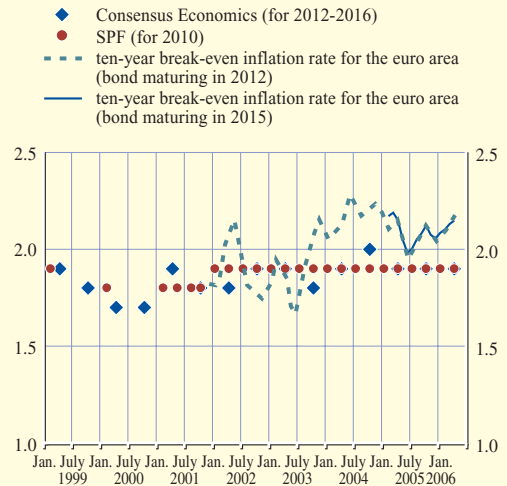
(percentages)



Source: ECB calculations.

Chart D Indicators of long-term inflation expectations

(average annual percentage changes)



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

the Q1 2002 SPF hides revisions by individual forecasters, which have offset each other. Chart B shows the percentage share of SPF participants that have revised their annual average long-term inflation expectations from one year to the next.² It indicates that many participants have revised their longer-term inflation expectation over time. On average, from 2002 to the first half of 2006, about half of the survey participants changed their expectations from one year to the next.

Whilst the average point estimate for longer-term inflation is stable and shows no sign of an increase, upside risks attached to long-term inflation expectations nevertheless continue to rise. This is indicated in Chart C, which shows that the average assessment of respondents on the probability of inflation five years ahead standing at or above 2.0% rose further in the second quarter of 2006 to 47.3%.

SPF survey results can also be compared with the “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 from the French government inflation-linked bonds (linked to the euro area HICP excluding tobacco) maturing in 2012 and 2015 have edged up somewhat since January 2006 (see Chart B).³ 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

2 Only those respondents that have actually participated in surveys for two consecutive years are included in the calculation. To obtain the percentage shares of forecasters revising their expectations, the annual average of long-term inflation expectations of individual SPF forecasters for two years is compared to check whether it has remained unchanged, or been revised upwards or downwards. Annual averages are rounded to one decimal point.

3 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, see the article entitled “Extracting information from financial asset prices” in the November 2004 issue of the Monthly Bulletin.

and liquidity premia). Consequently, developments in break-even inflation rates may partly reflect more 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 revised upwards their point estimate for real GDP growth in 2006 by 0.1 percentage point from the previous SPF round to 2.1%. The upward revision reflects improved expectations for domestic demand – especially for private consumption – and the external environment. According to several respondents, private consumption growth should benefit from improving labour market conditions and in part also from anticipated spending in the second half of 2006 to avoid the impact of the planned VAT hike in Germany in January 2007. Regarding the external environment, forecasters cited that the global economy is expected to remain robust in 2006 and to support euro area investment and exports. The point estimate for 2007 remained unchanged at 1.9%. On balance the risks for growth in 2006 and 2007 are assessed by SPF forecasters to be broadly neutral. However, in their qualitative explanations respondents stressed oil price increases, exchange rate developments and a possibly weaker than expected labour market improvement as possible downward risks to growth. Longer-term growth expectations (for 2010) are unchanged at 2.1%. Compared with other growth forecasts published recently, the SPF forecasts for real GDP growth for all horizons considered are slightly more optimistic than the results from Consensus Economics and the Euro Zone Barometer (see table).

Unemployment rate expectations for 2006 and 2007 have been revised down from the previous round by 0.1 percentage point. The unemployment rate is now expected to stand at 8.1% in 2006 and 7.9% in 2007. SPF forecasters justified the downward revisions mainly on account of stronger economic growth in the short term and the gradual expected impact of recent labour market reforms (e.g. in Germany) over time. The expected rate of unemployment in 2010 stands at 7.2%, unchanged compared with the previous round, but it is assessed to be uncertain and conditional on further labour market reforms.