

Box 3

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

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the third quarter of 2006, conducted between 17 and 22 July 2006. The SPF gathers information on expectations for euro area inflation, real GDP growth and the unemployment rate 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.

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

(annual percentage changes, unless otherwise indicated)

	Survey horizon					
	2006	June 2007	2007	June 2008	2008	Longer term ²⁾
HICP inflation						
2006 Q3 SPF	2.3	2.1	2.1	1.9	1.9	1.9
<i>Previous SPF (2006 Q2)</i>	2.1	-	2.1	-	-	1.9
Consensus Economics (July 2006)	2.2	-	2.1	-	-	1.9
Euro Zone Barometer (July 2006)	2.2	-	2.1	-	1.9	1.9
Real GDP growth						
2006 Q3 SPF	2.2	2.0	1.8	1.9	2.0	2.1
<i>Previous SPF (2006 Q2)</i>	2.1	-	1.9	-	-	2.1
Consensus Economics (July 2006)	2.2	-	1.8	-	-	1.9
Euro Zone Barometer (July 2006)	2.2	-	1.8	-	1.9	1.9
Unemployment rate¹⁾						
2006 Q3 SPF	7.9	7.7	7.7	7.5	7.5	7.0
<i>Previous SPF (2006 Q2)</i>	8.1	-	7.9	-	-	7.2
Consensus Economics (July 2006)	8.0	-	7.7	-	-	-
Euro Zone Barometer (July 2006)	8.0	-	7.8	-	7.7	7.3

1) As a percentage of the labour force.

2) In the current SPF round longer-term expectations refer to 2011. In the previous SPF round and the Euro Zone Barometer, longer-term forecasts refer to the year 2010. The Consensus Economics projections refer to the period 2012-16 (data published in the April 2006 Consensus Economics Survey).

Inflation expectations for 2006, 2007 and 2008

Average annual HICP inflation is now expected to stand at 2.3% in 2006¹, which implies an upward revision by 0.2 percentage point compared with the previous SPF round conducted in April 2006 (see table). Inflation is then forecast to decelerate to 2.1% in 2007 (unchanged from the previous round) and further to 1.9% in 2008, as SPF participants assume ongoing moderate wage developments. This outlook is expected to be largely shaped by oil price developments and the planned increase in German VAT in January 2007. Oil prices are seen as a major source of upward risk, particularly in 2006 and 2007, also reflecting a potentially stronger pass-through to domestic prices. However, their impact might be partly offset by a firmer euro exchange rate and some slowdown in growth. Moreover, several respondents clearly stated in their qualitative explanations that they do not see a risk of second-round effects, and consider contained wage growth as having an offsetting impact on inflation. SPF inflation expectations are broadly in line with the most recent estimates from Consensus Economics and the Euro Zone Barometer.

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 depicts the aggregate probability distributions for the average annual rate of HICP inflation in 2006 in the last three survey rounds, shows that, in line with the upward revision of the point estimate, the balance of risks clearly shifted towards higher outcomes in the latest SPF survey. On average, survey participants now believe that there is a probability of almost 90% that inflation

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

will be at or above 2% in 2006 on average, compared with 60% in the SPF round conducted in the first quarter of 2006. For 2007, the aggregate probability associated with inflation being at or above 2% also increased to around 70%, compared with somewhat above 50% in the first survey round of this year.

Indicators of longer-term inflation expectations

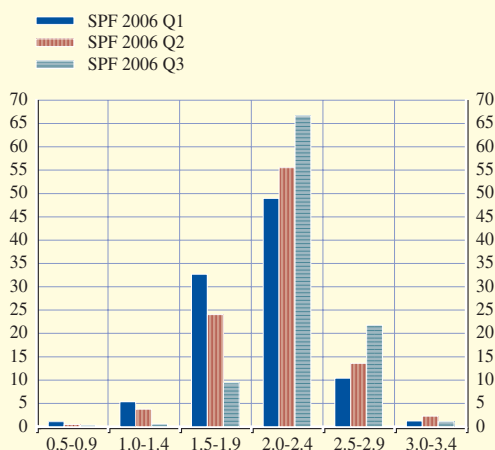
Inflation expectations five years ahead (for 2011) remained unchanged at 1.9% for the 19th consecutive SPF round. These expectations are in line with the most recent estimates from Consensus Economics for six to ten years ahead, and with those for 2010 published in the July 2006 Euro Zone Barometer.

Compared with the previous SPF round, the probability distribution assigned to longer-term inflation has shifted slightly back towards lower outcomes. In line with this, the probability that inflation may stand at 2% or above in the longer term fell back to 43.5%, after having risen to 47.3% in the previous round, suggesting some easing in the assessment of the perceived risks to longer-term inflation (see Chart B).

SPF survey results can also be compared with the break-even inflation rate, which is an indicator of longer-term inflation expectations among market participants calculated as the yield spread between nominal and inflation-linked bonds. As described in the article entitled “Measures of inflation expectations in the euro area” in the July 2006 issue of the Monthly Bulletin, the increasing offering of index-linked bonds in the euro area now allows the calculation of constant-maturity break-even inflation rates, which facilitates the comparison of break-even inflation rates and survey measures of longer-term inflation expectations. As shown in Chart C, the five-year forward break-even inflation rate five years ahead has remained broadly stable since April 2006. Similarly, the ten-year break-even inflation rates derived from the French

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

(percentages)



Source: ECB.

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%

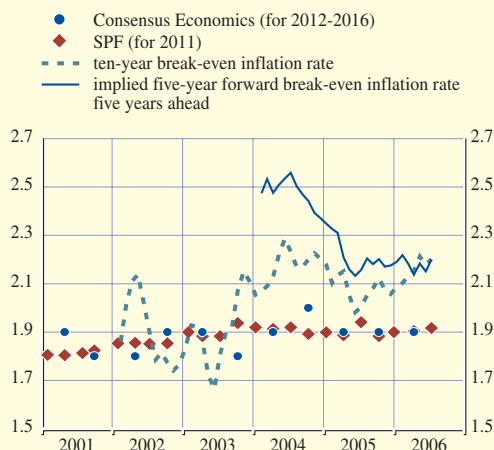
(percentages)



Source: ECB.

Chart C Longer-term inflation expectations from surveys and break-even inflation rates

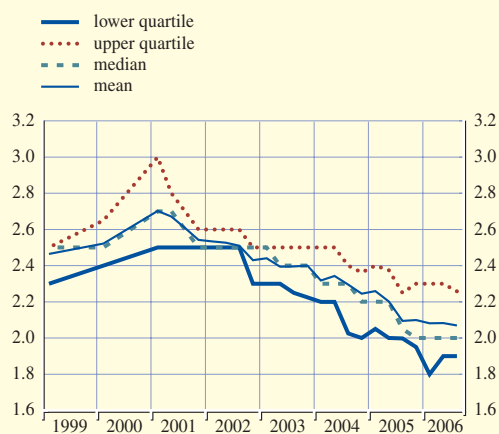
(annual percentage changes)



Sources: Consensus Economics, ECB, Reuters and ECB calculations.
 Note: Ten-year break-even inflation rate derived from 2012-maturity bonds until March 2005 and from 2015-maturity bonds thereafter.

Chart D Longer-term GDP growth expectations from the SPF – point estimates

(annual percentage changes)



Source: ECB.

government inflation-linked bonds (linked to the euro area HICP excluding tobacco) maturing in 2015 remained broadly unchanged over the same horizon. 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, developments in break-even inflation rates may partly reflect varying uncertainty among investors about future inflation and a resulting willingness to pay a varying premium for a hedge.

Real GDP growth expectations

Expectations for real GDP growth have been revised upwards by 0.1 percentage point for 2006 compared with the previous SPF round, and now stand at 2.2%. This upward revision mainly reflects perceptions of a more positive external environment which should support exports and domestic demand, especially private consumption and investment. According to several respondents, private consumption growth should also benefit from improving labour market conditions, the effects of the Football World Cup and in part also from anticipated spending in the second half of 2006 ahead 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. In 2007 and 2008 real GDP growth is then expected to decline slightly to 1.8% and 2.0% respectively, mainly reflecting high oil prices and a slowdown in the global economy. While in 2006 the balance of risks is assessed to be broadly neutral, in 2007 and 2008 survey participants perceive them to be more on the downside. SPF growth expectations for 2006, 2007 and 2008 are broadly in line with those from Consensus Economics and the Euro Zone Barometer.

Longer-term growth expectations (for 2011) remain unchanged at an average of 2.1%. According to most forecasters, longer-term growth prospects largely depend on further structural reforms in the labour markets and social security systems. They generally expect that more flexible and efficient markets will lead to higher labour productivity and higher growth. Looking at the evolution of the point estimates of longer-term real GDP growth provided by SPF forecasters and the variation in the estimates given by different respondents (see Chart D), longer-term growth expectations have not only declined gradually from levels at around 2.5% in 2001 but have also become more heterogeneous. However, the downward movement of both the 25th (lower quartile) and 75th percentiles (upper quartile) of the responses indicates that this more pessimistic assessment is relatively widespread. In addition, the median has been stable and somewhat lower than the mean in the last five SPF rounds, thereby suggesting that at the current juncture a large number of respondents have more pessimistic expectations about longer-term growth performance.

Expectations for the unemployment rate in the euro area

Unemployment rate expectations for 2006 and 2007 have been revised down from the previous round by 0.2 percentage point and now stand at 7.9% and 7.7% respectively. The downward revisions are mainly explained by improved economic conditions in 2006 and the positive impact of recent labour market reforms in both 2006 and 2007. However, some downward revisions to the back data may have also played a role. The unemployment rate is expected to continue to decline, to 7.5% in 2008 and 7.0% in 2011. Respondents continue to stress that the decline in the unemployment rate over the longer-term horizon is dependent on further labour market reforms, and that in the absence of such reforms the unemployment rate will be higher than forecast.