

Box 6

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

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the fourth quarter of 2006, which was conducted between 17 and 23 October 2006. The SPF gathers information on expectations for euro area inflation, GDP growth and unemployment from experts affiliated to financial or non-financial institutions based in the EU. The forecast was requested for the euro area as a whole, including Slovenia from 2007. 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, 2007 and 2008

Overall, SPF participants slightly lowered their inflation expectations for 2006. HICP inflation is now expected to stand at 2.2% in 2006, 0.1 percentage point lower than in the SPF round for the third quarter of 2006 (see table).¹ The main reason for this revision is the strong fall in oil prices in August and September, which has also led to lower than expected inflation over the past few months. Despite the recent decline in oil prices, average SPF inflation expectations for 2007 remained unchanged at 2.1%, which seems to reflect higher expectations for economic growth but also previously lower inflation expectations compared with other available forecasts.

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 the Euro Zone Barometer

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon					
	2006	Sep. 2007	2007	Sep. 2008	2008	Longer-term ²⁾
SPF Q4 2006	2.2	2.1	2.1	1.9	1.9	1.9
Previous SPF (Q3 2006)	2.3	-	2.1	-	1.9	1.9
Consensus Economics (October 2006)	2.3	-	2.2	-	1.9	1.9
Euro Zone Barometer (October 2006)	2.2	-	2.2	-	1.9	1.9
Real GDP growth	2006	Q2 2007	2007	Q2 2008	2008	Longer-term ²⁾
SPF Q4 2006	2.6	2.0	2.0	2.0	2.0	2.0
Previous SPF (Q3 2006)	2.2	-	1.8	-	2.0	2.1
Consensus Economics (October 2006)	2.6	-	1.9	-	1.9	1.9
Euro Zone Barometer (October 2006)	2.5	-	1.8	-	1.9	1.9
Unemployment rate ¹⁾	2006	Aug. 2007	2007	Aug. 2008	2008	Longer-term ²⁾
SPF Q4 2006	7.9	7.6	7.6	7.4	7.4	7.0
Previous SPF (Q3 2006)	7.9	-	7.7	-	7.5	7.0
Consensus Economics (October 2006)	7.9	-	7.6	-	-	-
Euro Zone Barometer (October 2006)	7.9	-	7.7	-	7.6	7.1

1) As a percentage of the labour force.

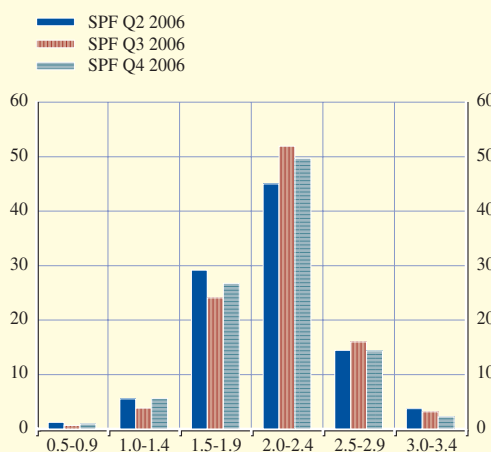
2) Longer-term expectations refer to 2011 in the SPF, 2010 in the Euro Zone Barometer and to the period 2012-16 in Consensus Economics.

The SPF forecast for 2007 remains 0.1 percentage point below the forecasts recently released by Consensus Economics and the Euro Zone Barometer. SPF participants expect inflation to decline on average in 2008 to 1.9%, unchanged from the previous round, and in line with the figures from the latest Consensus Economics and the Euro Zone Barometer. As in 2007, upward pressure from robust domestic demand is expected, but this could be counteracted by a slowdown of the world economy.

SPF participants were also asked to assign a probability distribution to their forecasts. This distribution provides information on the probability 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 distribution for average annual rates of HICP inflation in 2007 in the last three rounds of the survey, indicates a slight shift in the probability distribution towards lower outcomes compared with the previous round. There also appear to be some downside risks given that a larger part of the distribution falls in a range below the most likely range. However, when SPF participants reveal their explicit risk assessment, they mostly point to

Chart A Probability distribution for average inflation in 2007 in the last three rounds of the SPF¹⁾

(percentages)

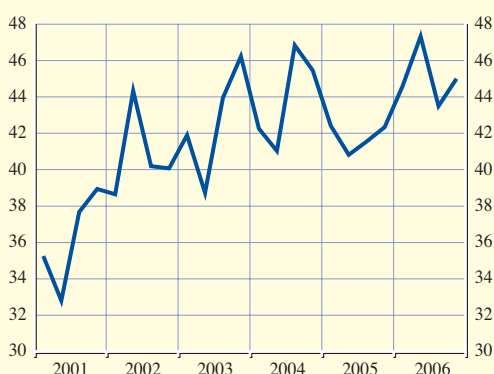


Source: ECB.

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

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

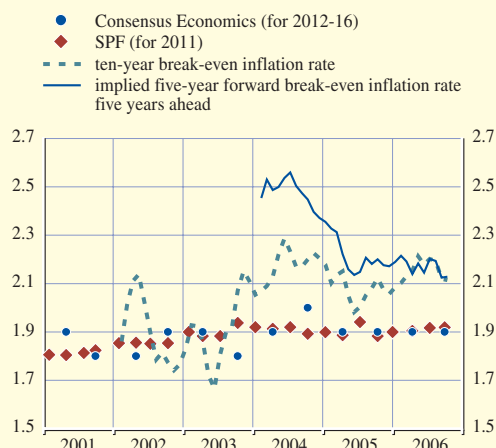
(percentages)



Source: ECB.

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

(average 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.

upward risks, particularly related to future oil price developments and government measures impacting on inflation. Wage developments are mainly expected to remain in check, since globalisation is seen to help contain wage growth. However, in the context of robust growth, some forecasters see a risk of higher wages due to second-round effects. Risks to the inflation outlook in 2008 are assessed to be clearly on the upside.

Indicators of longer-term inflation expectations

Longer-term inflation expectations (five years ahead) remained at 1.9% for the 20th consecutive survey. They are also in line with inflation expectations provided earlier in October by Consensus Economics for six to ten years ahead and by the Euro Zone Barometer regarding expectations for 2010. However, as Chart B shows, the probability that longer-term inflation may stand at 2.0% or above rose again somewhat, pointing to a slight increase in the perception of upward risks to price stability. Nevertheless, this probability remained below the peak observed in the second quarter of 2006.

SPF survey results can also be compared with the break-even inflation rate, an indicator of longer-term inflation expectations among market participants calculated as the yield spread between nominal and inflation-linked bonds.² The ten-year break-even inflation rate derived from the French government inflation-linked bonds (linked to the euro area HICP excluding tobacco) maturing in 2015 has declined since August 2006 (see Chart C). Similarly, the implied five-year forward break-even inflation rate five years ahead has been on an overall downward path since mid-2006. However, break-even inflation rates should not be interpreted as direct measures of inflation expectations as they may also incorporate various risk premia (e.g. inflation uncertainty and liquidity premia). Consequently, developments in break-even inflation

² See also the article entitled "Measures of inflation expectations in the euro area" in the July 2006 issue of the Monthly Bulletin.

rates may partly reflect more uncertainty among investors about future inflation and a resulting willingness to pay a premium for a hedge.

Real GDP growth expectations

Expectations for real GDP growth have been revised upwards by 0.4 percentage point for 2006 compared with the previous SPF round, and now point to real GDP growth of 2.6%. This upward revision mainly reflects the stronger than expected strengthening in growth in the first half of 2006 as well as higher expectations for growth in domestic demand (particularly in private consumption and investment). In addition, expectations for external demand have also been revised upwards, largely reflecting the continued strong expansion of the world economy. In 2007 and 2008, real GDP growth is then expected to decline to around 2.0%, mainly reflecting a slowdown in the global economy. In all three calendar years, the balance of risks to the growth outlook is assessed to be 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) have been revised downwards by 0.1 percentage point and now stand at 2.0%. According to most forecasters, longer-term growth prospects depend mainly on further structural reforms in the labour market and social security systems. Forecasters generally stress that more flexible and efficient markets will lead to higher labour productivity and output growth.

Expectations for the euro area unemployment rate

Unemployment rate expectations for 2006 remained unchanged at 7.9%, while expectations for 2007 and 2008 have been revised down by 0.1 percentage point and now stand at 7.6% and 7.4%, respectively. According to SPF forecasters, over the survey horizon, unemployment should benefit from the strong economic recovery and an improvement in the labour market. The balance of risks is assessed by participants to be on the downside in 2006 but more on the upside in 2007 and 2008. According to respondents' qualitative explanations, the upward risks surrounding the unemployment rate forecasts for 2007 and 2008 are mainly related to downside risks to the pace of economic growth and the possibility that the process of delocalisation of euro area firms to lower-cost countries could be intensified. The expected rate of unemployment in 2011 stands at 7.0%, unchanged from the previous round. The balance of risks derived from the aggregate probability distribution is assessed to be significantly on the upside. Respondents emphasise that the decline in the unemployment rate over the longer-term horizon is largely dependent on further labour market reforms and demographic factors.