

Box 4

RESULTS OF THE ECB SURVEY OF PROFESSIONAL FORECASTERS FOR THE FIRST QUARTER OF 2007

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the first quarter of 2007, which was conducted between 17 and 24 January 2007. 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. 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 2007 and 2008

SPF participants revised down on average their inflation expectations for 2007 to 2.0%, from 2.1% in the SPF round for the fourth quarter of 2006 (see table).¹ This downward revision largely reflects the recent fall in oil prices and generally lower oil price assumptions. Inflation is, however, expected to be affected by the German VAT increase in January, which SPF participants anticipate, on average, to add 0.3 percentage point to annual euro area inflation in 2007. SPF inflation expectations for 2007 are 0.1 percentage point lower than expectations reported in January 2007 by Consensus Economics and the Euro Zone Barometer. For 2008 SPF forecasters provided on average a picture of unchanged inflation expectations at 1.9%, the same average forecast as reported by both Consensus Economics and the Euro Zone Barometer. While wage developments are seen by SPF participants as remaining contained, stronger than currently expected wage growth is explicitly stated by professional forecasters to be a major risk to the inflation outlook, particularly in 2008. Another important risk, according to SPF

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)

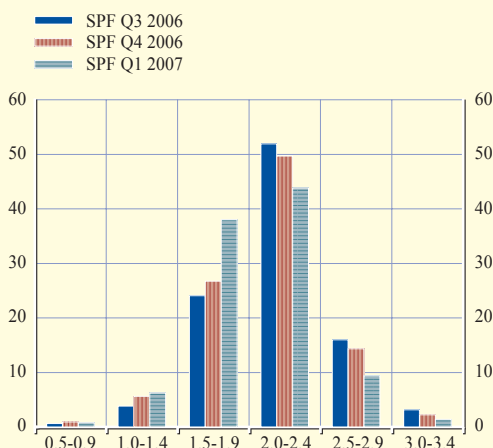
HICP inflation	Survey horizon				
	2007	Dec. 2007	2008	Dec. 2008	Longer-term ²⁾
SPF Q1 2007	2.0	2.0	1.9	1.9	1.9
Previous SPF (Q4 2006)	2.1	-	1.9	-	1.9
Consensus Economics (January 2007)	2.1	-	1.9	-	1.9
Euro Zone Barometer (January 2007)	2.1	-	1.9	-	1.9
Real GDP growth	2007	Q3 2007	2008	Q3 2008	Longer-term ²⁾
SPF Q1 2007	2.1	2.1	2.1	2.1	2.1
Previous SPF (Q4 2006)	2.0	-	2.0	-	2.0
Consensus Economics (January 2007)	2.0	-	2.1	-	1.9
Euro Zone Barometer (January 2007)	2.0	-	2.0	-	2.0
Unemployment rate ¹⁾	2007	Nov. 2007	2008	Nov. 2008	Longer-term ²⁾
SPF Q1 2007	7.5	7.4	7.3	7.2	6.9
Previous SPF (Q4 2006)	7.6	-	7.4	-	7.0
Consensus Economics (January 2007)	7.5	-	7.3	-	-
Euro Zone Barometer (January 2007)	7.6	-	7.4	-	6.9

1) As a percentage of the labour force.

2) Longer-term expectations refer to 2011 for the SPF and Euro Zone Barometer and to the period 2012-16 for Consensus Economics (data published in the October 2006 Consensus Economics Survey).

Chart A Probability distribution for average inflation in 2007 in the last three rounds of the SPF ¹⁾

(percentages)

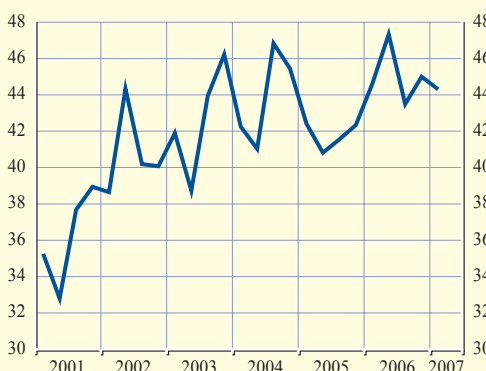


Source: ECB.

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

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

(percentages)



Source: ECB.

participants, is a rebound in oil prices, and a few respondents also referred to government measures as posing upside risks to inflation.

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 makes it easier to assess how, on average, survey participants gauge the risk of the actual outcome being above or below the most likely range. In line with the downward revision of the point estimate for 2007, the probability distribution for expected inflation this year has shifted towards lower outcomes compared with the SPF round for the fourth quarter of 2006 (see 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). As a result, survey participants now perceive a 45% likelihood that inflation will stand below 2.0% in 2007, compared with 33% in the previous round. By contrast, there was little variation in the probability distribution for inflation in 2008, although respondents appear slightly more confident of the outturn being in the central interval of 1.5-1.9%. However, there is still a probability of almost 45% associated with inflation being at or above 2%.

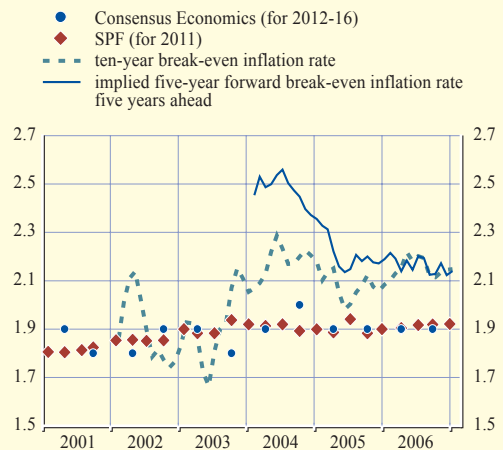
Indicators of longer-term inflation expectations

Longer-term inflation expectations (five years ahead) remained firmly anchored at 1.9% in the 21st consecutive survey. They are fully aligned with the newly released expectations from the Euro Zone Barometer for 2011 and the October 2006 results from Consensus Economics for inflation expectations six to ten years ahead. The average probability distribution for longer-term inflation expectations was unchanged compared with the previous round, with the bulk of the distribution falling in the 1.5-1.9% interval. The probability that inflation will stand at 2% or above five years ahead was also broadly stable at 44% (see Chart B), suggesting an unchanged perception of upward risks to price stability.

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 French government inflation-linked bonds (linked to the euro area HICP excluding tobacco) maturing in 2015 has been stable over recent months (see Chart C). Similarly, the implied five-year forward break-even inflation rate has shown little movement since October 2006. However, break-even inflation rates should not be interpreted as direct measures of inflation expectations, since they may also incorporate various risk premia (such as inflation uncertainty and liquidity premia).

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.

Real GDP growth expectations

Expectations for real GDP growth have been revised slightly upwards, by 0.1 percentage point, for 2007 in comparison with the previous SPF round, and now point to real GDP growth at 2.1%. This upward revision mainly reflects improved expectations for domestic demand (in particular private consumption and investment) and for external demand. Expected GDP growth for 2008 has also been revised up by 0.1 percentage point to 2.1%. In both years the risks surrounding the forecasts are assessed to be more on the downside, mostly related to oil prices and global imbalances. Overall, SPF growth expectations for 2007 and 2008 are slightly more optimistic than those reported in the January 2007 Euro Zone Barometer and Consensus Economics. Longer-term growth expectations have also been revised upwards by 0.1 percentage point to 2.1%. According to forecasters, longer-term growth prospects depend principally on further structural reforms in the labour market and social security systems, immigration and improved productivity through ICT spreading in the economy. In general, forecasters reiterated their expectation that more flexible and efficient markets will lead to higher labour productivity and higher growth.

Expectations for the euro area unemployment rate

Unemployment rate expectations for 2007 and 2008 have been revised downwards by 0.1 percentage point and now stand at 7.5% and 7.3% respectively. According to SPF forecasters, unemployment in both years should benefit mainly from ongoing economic growth. As in the previous SPF round, the balance of risks derived from the aggregate distribution is still on the upside for 2007 and 2008, mainly related to the risk of lower economic growth. SPF unemployment rate expectations for 2007 and 2008 are broadly aligned with those reported by Consensus Economics and the Euro Zone Barometer. Longer-term unemployment rate expectations have also been revised down by 0.1 percentage point, to 6.9% in 2011. The balance

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

of risks derived from the aggregate probability distribution is on the upside in the longer term. Respondents continue to say that the decline in the unemployment rate over the longer-term horizon is mainly dependent on further labour market reforms and on demographic factors.