

Box 5

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

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the fourth quarter of 2007. The survey was conducted between 16 and 18 October 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. 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, 2008 and 2009

SPF participants have not revised their inflation expectations, which remain at 2% for the average rate of inflation in 2007, 2008 and 2009 (see table)¹. The inflation forecasts reflect the expectation that unfavourable energy-related base effects will keep inflation high over the fourth quarter of 2007 and early 2008. By contrast with the previous round of the survey, participants expect stronger price pressures coming from high oil, food and commodity prices to be counterbalanced by weaker economic activity. SPF inflation expectations are within the ranges reported in the September 2007 ECB staff macroeconomic projections and in line with the forecasts published in the October 2007 issues of Consensus Economics and the Euro Zone Barometer.

The risks surrounding these inflation expectations are assessed by the participants to be mainly on the upside, related in particular to unexpected future hikes in oil prices, food price increases, rising non-energy commodity prices, capacity constraints and wage pressures stemming from tight labour market conditions. At the same time, several respondents mention that a further appreciation of the euro and lower than expected world GDP growth pose downside risks to the inflation expectations.

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. The probability distributions for expected

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, ECB staff macroeconomic projections, Consensus Economics and Euro Zone Barometer

(annual percentage changes, unless otherwise indicated)

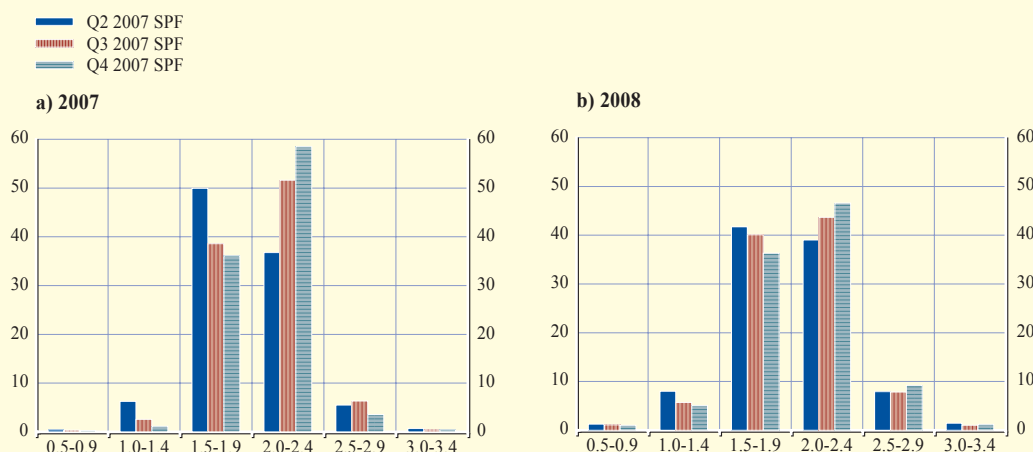
HICP inflation	Survey horizon					
	2007	Sep. 2008	2008	Sep. 2009	2009	Longer term ²⁾
SPF Q4 2007	2.0	2.0	2.0	1.9	2.0	1.9
Previous SPF (Q3 2007)	2.0	-	2.0	-	2.0	2.0
ECB staff macroeconomic projections	1.9-2.1	-	1.5-2.5	-	-	-
Consensus Economics (October 2007)	2.0	-	2.0	-	2.0	1.9
Euro Zone Barometer (October 2007)	2.0	-	2.0	-	2.0	2.0
Real GDP growth	2007	Q2 2008	2008	Q2 2009	2009	Longer term ²⁾
SPF Q4 2007	2.6	2.1	2.1	2.2	2.2	2.2
Previous SPF (Q3 2007)	2.7	-	2.3	-	2.2	2.2
ECB staff macroeconomic projections	2.2-2.8	-	1.8-2.8	-	-	-
Consensus Economics (October 2007)	2.6	-	2.0	-	2.1	2.0
Euro Zone Barometer (October 2007)	2.6	-	2.1	-	2.1	2.0
Unemployment rate ¹⁾	2007	Aug. 2008	2008	Aug. 2009	2009	Longer term ²⁾
SPF Q4 2007	7.0	6.7	6.7	6.6	6.6	6.4
Previous SPF (Q3 2007)	7.0	-	6.7	-	6.6	6.4
Consensus Economics (October 2007)	7.0	-	6.7	-	-	-
Euro Zone Barometer (October 2007)	6.8	-	6.7	-	6.6	6.3

1) As a percentage of the labour force.

2) Longer-term inflation expectations refer to 2012 in the SPF, 2011 in the Euro Zone Barometer and to the period 2013-17 in Consensus Economics. The Consensus Economics forecasts for the period 2013-17 and the year 2009 were published in the October 2007 issue of Consensus Economics.

Chart A Probability distribution for average annual inflation in 2007 and 2008 in the last three rounds of the SPF ¹⁾

(probability in percentages)



Source: ECB.

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

inflation in 2007 and 2008 have shifted towards higher outcomes than in the SPF round for the third quarter of 2007 (see Chart A). The bulk of responses is now concentrated in the interval 2.0%-2.4% for both years.

Indicators of longer-term inflation expectations

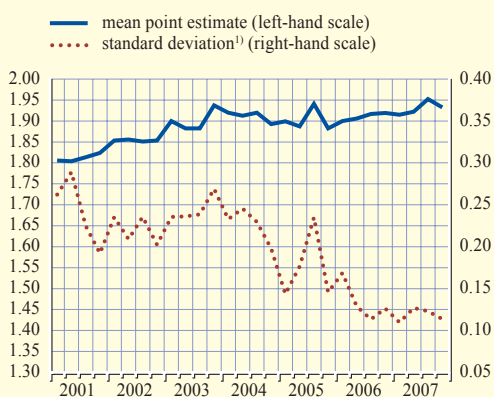
According to the latest SPF results, longer-term inflation expectations (five years ahead) have been revised down from 1.95% to 1.93%. Using one decimal place, this revision leads to a change from 2.0% to 1.9% owing to rounding. These point expectations are slightly below the expectations from the Euro Zone Barometer for 2011 but in line with those from Consensus Economics for inflation six to ten years ahead, both released in October 2007. The standard deviation of longer-term inflation expectations in the SPF has fallen over time. This indicates a broader consensus among respondents regarding the forecast for the longer-term inflation rate (see Chart B).

The probability attached by survey respondents to long-run inflation standing at 2% or above increased to 48%, compared with 47% in the previous round (see Chart C). These survey results can 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 bonds². The rise in the probability that inflation five years ahead will stand at 2% or above is in line with developments in the implied five-year forward five-year break-even inflation rate (see Chart C). It should be recalled that 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).

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

**Chart B Longer-term inflation expectations
(point estimate – five years ahead)**

(average annual percentage changes; percentage points)

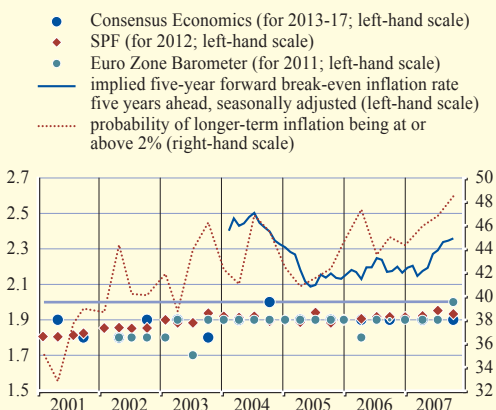


Source: ECB.

1) The standard deviation of point estimates reported by each of the panel members responding to the survey.

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

(average annual percentage changes; percentage probability)



Sources: Consensus Economics, Euro Zone Barometer, ECB, Reuters and ECB calculations.

Real GDP growth expectations

Expectations for real GDP growth have been revised downwards by 0.1 percentage point for 2007 and by 0.2 percentage point for 2008 in comparison with the previous SPF round. The estimates now point to real GDP growth of 2.6% in 2007 and 2.1% in 2008. These downward revisions mainly reflect two factors. First, investment growth is expected to be lower than previously anticipated owing to tighter credit standards and higher capital costs in the wake of recent credit market developments. Second, euro area exports are expected to be negatively affected by the appreciation of the euro and somewhat moderating world growth on account of a weaker than previously expected expansion of the US economy. At the same time, several forecasters highlight the continuous improvement in the euro area labour markets as an indicator of the resilience of the euro area economy to the financial turbulence. Expected GDP growth for 2009 has remained unchanged at 2.2%.

In all years, the risks surrounding these expectations are assessed by the respondents to be on the downside, mainly related to the rise in oil prices and the euro exchange rate, the uncertainty surrounding the developments in the financial markets and the possibility of a stronger than expected slowdown in the US economy.

SPF growth expectations for 2007 and 2008 are within the ranges of the September 2007 ECB staff macroeconomic projections and broadly in line with the results published in the latest issues of the Euro Zone Barometer and Consensus Economics. For 2009, the point estimate of the real GDP growth rate is slightly above the results of the October 2007 issues of the Euro Zone Barometer and Consensus Economics.

Longer-term growth expectations (i.e. for 2012) have not been revised and remain at 2.2%. According to SPF participants, longer-term growth prospects depend principally on further

structural reforms in the labour market and social security systems, as well as on migration flows.

Expectations for the euro area unemployment rate

Unemployment rate expectations for 2007, 2008 and 2009 have not been revised and stand at 7.0%, 6.7% and 6.6% respectively. Forecasters expect favourable labour market trends to continue, while further reductions in the unemployment rate are seen as being subject to the success of labour market reforms. SPF unemployment rate expectations for 2007 and 2008 are in line with those of the latest issue of Consensus Economics. The SPF forecasts for the unemployment rate are slightly above the expectations in the October 2007 issue of the Euro Zone Barometer for 2007, but in line with those for 2008 and 2009.

Longer-term unemployment rate expectations have not been revised and stand at 6.4% for 2012. The balance of risks to these forecasts is assessed to be on the upside over all horizons. Respondents continue to indicate that the decline in the unemployment rate over the longer-term horizon is mainly dependent on further, and deeper, labour market reforms.