

Box 6

RESULTS OF THE ECB SURVEY OF PROFESSIONAL FORECASTERS FOR THE FOURTH QUARTER OF 2010

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the fourth quarter of 2010. The survey was conducted between 15 and 20 October 2010. There were 61 responses from forecasters. The SPF collects information on expectations for euro area inflation, real GDP growth and unemployment from experts affiliated with financial or non-financial institutions that are based in the EU.¹

Inflation expectations for 2010, 2011 and 2012

Inflation is expected to be at 1.5% in 2010 and 2011, and 1.6% in 2012. The outlook for inflation in the short to medium term is broadly unchanged from the last SPF round, up by 0.1 percentage point for 2010, unchanged for 2011 and down by 0.1 percentage point for 2012 (see the table below).²

The SPF inflation expectations for 2010 and 2011 are within the ranges reported in the September 2010 ECB staff macroeconomic projections. Compared with the forecasts of the October 2010 issues of Consensus Economics and the Euro Zone Barometer, the SPF inflation expectations are broadly similar for all horizons.

The SPF participants were also asked to assess the probability of inflation falling within specific intervals. Compared with the previous SPF round, the aggregate probability distribution for 2010

1 Given the diversity of the panel of participants, aggregate SPF results can reflect a relatively heterogeneous set of subjective views and assumptions.

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

Results of the SPF, ECB staff macroeconomic projections, Consensus Economics and Euro Zone Barometer

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon					
	2010	September 2011	2011	September 2012	2012	Longer-term ²⁾
SPF Q4 2010	1.5	1.5	1.5	1.7	1.6	1.9
<i>Previous SPF (Q3 2010)</i>	1.4	-	1.5	-	1.7	2.0
ECB staff macroeconomic projections	1.5-1.7	-	1.2-2.2	-	-	-
Consensus Economics (October 2010)	1.5	-	1.6	-	1.5	2.0
Euro Zone Barometer (October 2010)	1.5	-	1.4	-	1.7	1.9
Real GDP growth	2010	Q2 2011	2011	Q2 2012	2012	Longer-term ²⁾
SPF Q4 2010	1.6	1.3	1.5	1.6	1.7	1.8
<i>Previous SPF (Q3 2010)</i>	1.1	-	1.4	-	1.6	1.8
ECB staff macroeconomic projections	1.4-1.8	-	0.5-2.3	-	-	-
Consensus Economics (October 2010)	1.6	1.3	1.4	1.4	1.6	1.7
Euro Zone Barometer (October 2010)	1.6	1.2	1.4	-	1.6	1.8
Unemployment rate ¹⁾	2010	August 2011	2011	August 2012	2012	Longer-term ²⁾
SPF Q4 2010	10.1	10.0	10.0	9.6	9.6	8.3
<i>Previous SPF (Q3 2010)</i>	10.1	-	10.2	-	9.8	8.4
Consensus Economics (October 2010)	10.0	-	9.9	-	-	-
Euro Zone Barometer (October 2010)	10.0	-	10.0	-	9.4	8.5

1) As a percentage of the labour force.

2) Longer-term inflation expectations refer to 2014 in the Euro Zone Barometer and to 2015 in the SPF for the fourth quarter of 2010 and Consensus Economics.

is now more concentrated in the range between 1.5% and 1.9%, as respondents assign a 57% probability to this interval. The probability distributions for 2011 and 2012 have remained broadly stable compared with the previous SPF round, with a slight increase in the probability of inflation outcomes being in the range from 1.5% to 1.9% for 2011 (see Chart A). Based on the individual probability distributions, the balance of risks to these forecasts is assessed by respondents as being broadly balanced for 2010 and 2012, and on the downside for 2011. According to respondents' comments, upside risks to the baseline scenario are: i) increasing oil, commodity and food prices; and ii) increases in indirect taxation and administered prices as a result of fiscal consolidation plans. The main downside risks to the inflation outlook in the short to medium term are perceived to be: i) low wage pressure due to the high unemployment rate; and ii) relatively sluggish growth, resulting in protracted economic slack. Possible changes in the USD/EUR exchange rate are mentioned as both upside and downside risks because of their impact on import prices.

Indicators of longer-term inflation expectations

Longer-term inflation expectations (for 2015) have been revised downwards slightly, on average, to 1.90% from 1.95% in the previous SPF round. The median of the point forecasts, which is less affected by extreme values than the average point forecast, remained at 1.9%. The average point forecast is slightly below the long-term inflation forecast provided by Consensus Economics for 2015 (at 2.0%) and in line with that of the Euro Zone Barometer for 2014 (at 1.9%).

The disagreement among forecasters in their longer-term inflation expectations, as measured by the standard deviation of their point forecasts, has remained at a slightly higher level since 2009, reflecting some outliers. However, the 25th and 75th percentiles have remained broadly stable over the last few years, at 2.0% and 1.8% respectively (see Chart B).

Chart A Probability distribution for average annual inflation in 2011 and 2012 in the latest SPF rounds ¹⁾

(probability in percentages)

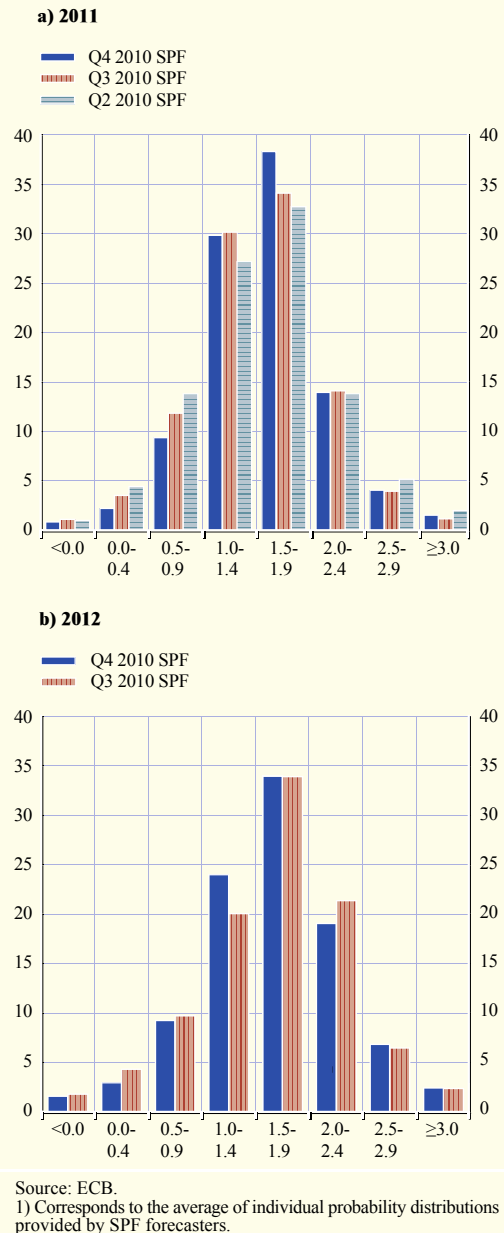
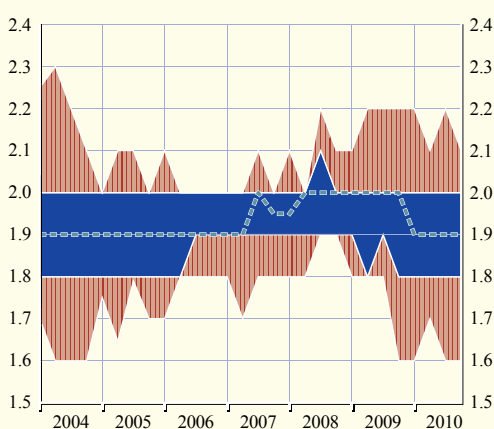


Chart B Longer-term (2015) inflation point forecasts of the SPF respondents

(annual percentage changes)

- range between 25th and 75th percentiles
- range between 10th and 90th percentiles
- median of the point forecasts



Source: ECB.

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

(average annual percentage changes; five-day moving averages of daily data)

- SPF (for 2015)
- ▲ Consensus Economics (for 2015)
- Euro Zone Barometer (for 2014)
- implied five-year forward break-even inflation rate five years ahead, seasonally adjusted



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

Aggregate uncertainty surrounding longer-term inflation expectations, as measured by the standard deviation of the aggregate probability distribution, has picked up slightly compared with the previous SPF round.³ Finally, the probability of longer-term inflation standing at 2% or above remained broadly stable, at 45%.

Measures of inflation expectations derived from financial markets declined over August and September, but picked up during October. It is important to note that these measures incorporate not just the level of expected inflation, but also an additional premium to compensate bond investors for inflation risks. In general, they are also more volatile than survey-based measures, not only owing to the volatility of the inflation risk premium, but also to fluctuations in bond market liquidity conditions, particularly since the middle of 2008 (see Chart C).⁴ For these reasons, the volatility observed in these measures should not be mechanically interpreted as reflecting revisions in market participants' long-term inflation expectations.⁵

Real GDP growth expectations

GDP growth expectations for the short to medium term have been revised upwards for all horizons and now stand at 1.6% (up by 0.5 percentage point) for 2010, 1.5% (up by 0.1 percentage point) for 2011 and 1.7% (up by 0.1 percentage point) for 2012 (see table).

³ For a discussion regarding uncertainty measures, see the box entitled "Measuring perceptions of macroeconomic uncertainty", *Monthly Bulletin*, ECB, January 2010.

⁴ See also the article entitled "Measures of inflation expectations in the euro area", *Monthly Bulletin*, ECB, July 2006.

⁵ For further discussion on the impact of the financial market crisis on market-based measures of inflation expectations, see the box entitled "Recent increases in real yields and their implications for the analysis of inflation expectations", *Monthly Bulletin*, ECB, November 2008. Recent developments in financial market indicators of inflation expectations are discussed in Section 2.4 of the *Monthly Bulletin*.

The SPF growth expectations for 2010 and 2011 are in the middle of the ranges reported in the September 2010 ECB staff macroeconomic projections for the euro area and broadly in line with the latest Consensus Economics and Euro Zone Barometer forecasts for 2010 and 2011.

The aggregate probability distribution for 2010 has shifted considerably towards higher outcomes, as respondents now assign a 58% probability to outcomes between 1.5% and 1.9%. With respect to 2011 and 2012, the aggregate probability distributions have shifted slightly towards higher outcomes compared with the last SPF round. For both horizons, the respondents assign a close to 60% probability to GDP growth being in the interval between 1.0% and 1.9% (see Chart D).

The level of uncertainty surrounding one-year-ahead and two-year-ahead real GDP forecasts has not changed from the previous SPF round. The balance of risks to the average point forecast of real GDP growth is assessed to be on the downside across all forecast horizons, and for 2010 in particular. According to forecasters' comments, the main downside risks relate to weaker growth in the United States and a slowdown in emerging economies. Upside risks to growth mentioned include: i) improved confidence, leading to a strengthening of domestic demand; ii) a recovery in the labour market; and iii) success of the planned fiscal consolidation measures.

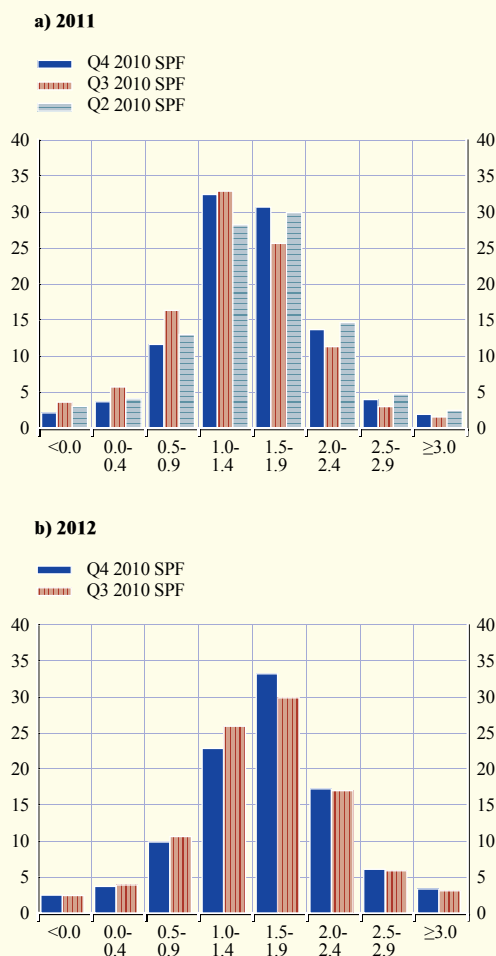
Longer-term growth expectations (for 2015) stand at 1.8%, unchanged from the previous SPF round. The SPF assessment is in line with that of the Euro Zone Barometer (for 2014) and 0.1 percentage point higher than that of Consensus Economics (for 2015). Looking at the individual probability distributions, the respondents assess the balance of risks for longer-term growth to be on the downside.

Expectations for the euro area unemployment rate

Unemployment rate expectations remain unchanged at 10.1% for 2010 and have been revised downwards by 0.2 percentage point for 2011 and 2012, to 10.0% and 9.6% respectively.

Chart D Probability distribution for average annual real GDP growth in 2011 and 2012 in the latest SPF rounds ¹⁾

(probability in percentages)



Source: ECB.
1) Corresponds to the average of individual probability distributions provided by SPF forecasters.

The balance of risks to short and medium-term expectations is assessed to be on the upside. Longer-term unemployment rate expectations (for 2015) have been revised downwards slightly, by 0.1 percentage point, to 8.3%, and the balance of risks to the longer-term outlook is again assessed to be on the upside.

Other variables and conditioning assumptions

According to other information provided by the respondents, they generally expect i) oil prices to increase from USD 80 in the fourth quarter of 2010 to around USD 88 in 2012; ii) average annual wage growth to be at 1.5% in 2010, rising to 1.6% in 2011, 1.8% in 2012 and 2.4% in 2015; iii) the euro to weaken against the US dollar, to stand on average at USD 1.34 in 2011 and USD 1.32 in 2012; iv) the ECB policy rate to remain stable at around 1.0% until the second quarter of 2011 and then increase to around 1.8%, on average, in 2012.