

DEVELOPMENTS IN LONGER-TERM GROWTH EXPECTATIONS FOR THE EURO AREA

Several economic surveys for the euro area ask participants about their expectations for real GDP growth four or more years ahead. This horizon is long enough to not be influenced by cyclical considerations and, therefore, to represent long-term average (potential) growth prospects. Changes in such prospects can, for instance, reflect expectations of permanent changes in the factors determining long-run growth, such as labour force or productivity growth. However, they can also be triggered by excessive cyclical movements and protracted adjustment processes, as they may occur after boom/bust episodes. In this respect, economic developments since the onset of the financial crisis, and the adjustment processes that were set in motion subsequently, may have impacted the longer-term growth outlook and/or the uncertainty surrounding it. Against this background, this box reviews developments in longer-term expectations for real GDP growth in the euro area.

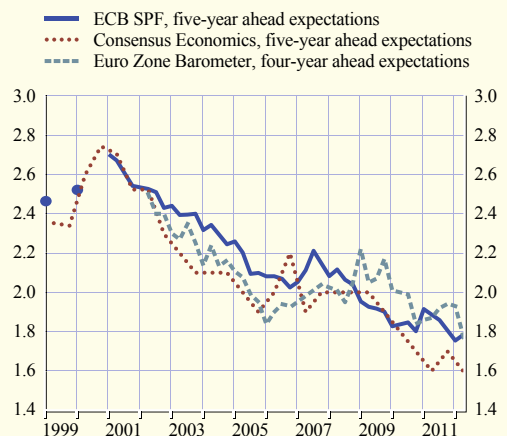
Developments in the mean of longer-term growth expectations

Over the period since 1999, the results from the ECB Survey of Professional Forecasters¹ (SPF), Consensus Economics and the Euro Zone Barometer all point to a broad downward trend in longer-term growth expectations for the euro area (see Chart A). This is consistent with developments in the estimates of euro area potential output growth provided by international organisations, which have also generally followed a downward trend over the same period (see Chart B). In the pre-crisis period, this downward trend was mostly due to a lower contribution from so-called total factor productivity, which, together with the growth of available labour and capital, accounts for potential output growth. The financial crisis and the subsequent recession then also had a strong negative impact on the longer-term growth of labour and capital, for instance, via a higher structural rate of unemployment, and protracted adverse investment dynamics. More generally, euro area longer-term growth prospects are affected by population ageing, which dampens the rate of growth of the future working population.²

Within the downward trend of survey expectations for the level of longer-term real

Chart A Longer-term growth expectations for the euro area

(annual percentage changes)



Sources: ECB, Consensus Economics, and the Euro Zone Barometer.

Notes: In 1999 and 2000 the SPF collected five-years ahead inflation expectations only in the first quarter. The Euro Zone Barometer and Consensus Economics started collecting data for the euro area in 2002 and 2003, respectively. Consensus Forecasts prior to 2003 have been constructed as averages of country forecasts for Germany, France, Italy, the Netherlands and Spain using GDP weights.

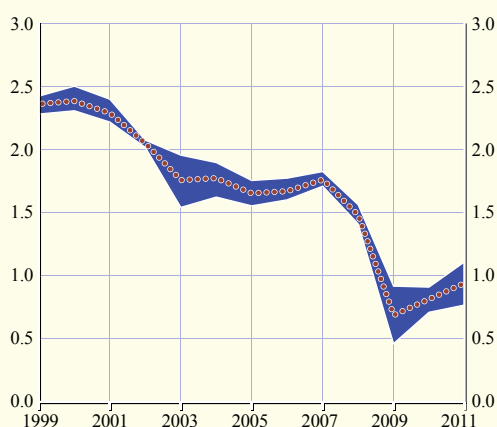
¹ The survey gathers information on expectations for euro area inflation, real GDP growth and unemployment, on a quarterly basis, from experts affiliated with financial or non-financial institutions that are based in the EU. Data are available on the ECB's website at www.ecb.europa.eu/stats/prices/indic/forecast/html/index.en.html

² For a discussion of the concept of potential output and of developments in potential output estimates for the euro area, see the article entitled "Trends in potential output", *Monthly Bulletin*, ECB, January 2011.

Chart B Potential output estimates

(year-on-year percentage changes)

..... average of the OECD, IMF and Commission estimates

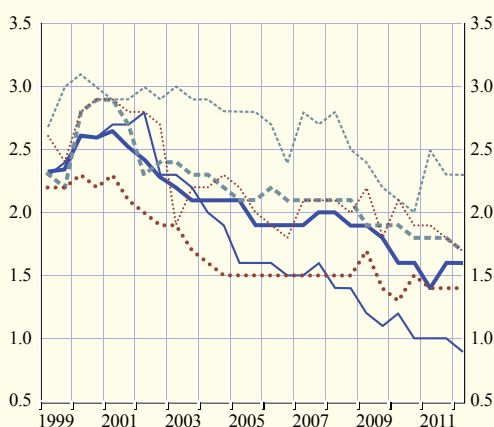


Sources: Economic Outlook, OECD, November 2011; World Economic Outlook, IMF, April 2012; and European Commission, AMECO database, spring 2012.
Note: The shaded area indicates the range of estimates.

Chart C Longer-term growth expectations for the euro area and the larger euro area economies

(annual percentage changes)

— euro area — Italy
..... Germany Netherlands
- - - France - - - Spain



Source: Consensus Economics.
Note: Expectations for the average growth rate between six and ten years ahead are available only at one decimal.

GDP growth, there were different phases of developments. In particular, expectations increased visibly during 2000/2001, when expectations were for permanently higher productivity growth related to progress in IT technology. Longer-term growth expectations reached an all-time high of 2.7% at the beginning of 2001. Subsequently, they decreased steadily, to stabilise and rebound somewhat in the pre-crisis period. The pick-up to 2.2% recorded just before the onset of the crisis coincided with a boom period, recording continued actual real GDP growth rates of around and sometimes well above 3%. With the onset of the crisis, longer-term growth expectations resumed the earlier downward trend and currently stand at around 1.7%.

The parallelism between specific actual business cycle phases and movements in longer-term growth expectations suggests that expectations have not only been determined by structural factors but have also been influenced by waves of growth optimism and pessimism.

Similar observations for the euro area as a whole can be made for developments in longer-term growth expectations for the larger euro area countries. Consensus Economics data show that all of the countries under review, with the exception of Germany, shared an improvement in longer-term growth expectations in the early 2000s related to the expectation of an IT-driven “New Economy” and possibly also to the economic impact of Monetary Union (see Chart C). The subsequent deterioration in longer-term growth prospects took place at a different pace depending on the country in question, with the sharpest declines being recorded in Italy and the Netherlands (which observed a housing boom in the early 2000s). The stabilisation of aggregate expectations prior to the crisis appears to have been mostly due to a stabilisation in expectations for France and Germany, while the resumption of the downward trend after the crisis was driven mainly by expectations for Spain, reflecting the bust phase of the economic cycle.

Looking at the entire period, as of 1999, longer-term growth expectations for Germany have been consistently below the average expectations for the euro area as a whole, remaining relatively stable at around 1.5%. Longer-term growth expectations for Italy have been below the euro area average as well, but on a downward trend. At the same time, longer-term growth expectations for the Netherlands and France have been broadly in line with expectations for the euro area, while expectations for Spain have been at a considerably higher level compared with other large euro area countries and with the euro area as a whole.

Developments in longer-term growth expectations in other advanced economies share some of the features displayed for the euro area. The upward movement in the early 2000s is also visible for the United States and Japan, and is steeper than that of the euro area (see Chart D). While growth expectations for the United Kingdom remained stable in that period, they rose in the run-up to the crisis, when expectations for the United States were already on the decline.

In the period since 1999, longer-term growth expectations for the United States have been consistently higher than those for the other economies. This is consistent with potential output growth estimates for the United States, which have always been higher than those of the euro area. With regard to Japan, the relatively low level of longer-term growth expectations might be related to the protracted adjustment phase following the excessive asset price movements in the 1990s, and to the ageing population.

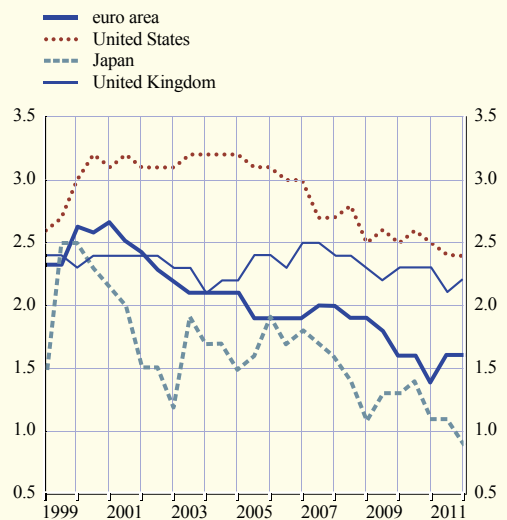
Developments in uncertainty surrounding longer-term growth expectations

Since the onset of the financial crisis, the degree of macroeconomic uncertainty surrounding the economic outlook has heightened considerably. An increase in uncertainty surrounding longer-term growth prospects can, for example, be reflected in an increase in disagreement among survey participants about the outcome they consider most likely. In this respect, the coefficient of variation³ of the distribution of SPF individual point forecasts represents a measure of disagreement amongst participants (see Chart E). Disagreement peaked in the second quarter of 2009, in the midst of the recession, but then reverted back to a level slightly above the pre-crisis level. Another indicator of uncertainty is the coefficient of variation derived from the aggregate probability distribution (averaging out the individual distributions that SPF respondents are asked to provide together with their point forecasts). This measure started to increase at the end of 2008

³ The coefficient of variation corresponds to the standard deviation of the distribution divided by the mean of the distribution. It is appropriate to normalise the standard deviation because longer-term growth expectations display a trend.

Chart D Longer-term growth expectations for the euro area, the United States, Japan and the United Kingdom

(annual percentage changes)



Source: Consensus Economics.

Notes: Expectations for the average growth rate between six and ten years ahead are available only at one decimal. The observation for Japan in April 2001 has been interpolated.

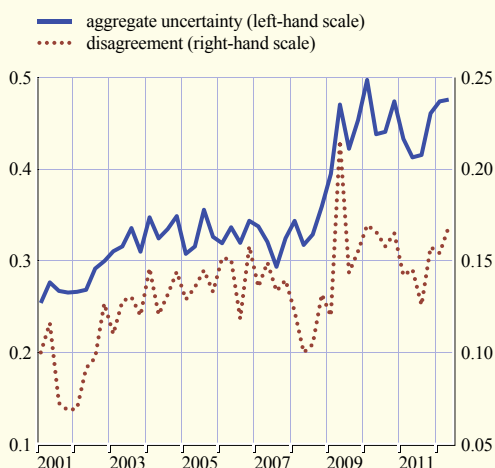
and has fluctuated around relatively high levels since 2009 (see Chart E). Taken together, the two indicators of uncertainty suggest that respondents are now less confident about their point estimates than before.

Overall, longer-term expectations for euro area real GDP growth have been on a broad downward trend since the early 2000s. This is consistent with lower contributions from total factor productivity growth, but more recently also lower growth in labour and capital emerging from estimates of euro area potential output growth. At the same time, hiccups in the downward trend of longer-term survey expectations were observed around times of particularly favourable economic developments. In addition, it is notable that following the 2009 recession, uncertainty surrounding longer-term growth developments increased considerably. Since overall uncertainty is likely to have a negative impact

on economic outcomes, inducing for example a deferral of firms' investment decisions, as well as a more cautious attitude on the part of households, higher uncertainty surrounding longer-term growth prospects may in itself also be a factor contributing towards worsening longer-term growth expectations for the euro area in recent times.

Chart E Uncertainty and disagreement about longer-term growth expectations from the SPF

(percentages)



Source: ECB.

Note: Aggregate uncertainty is defined as the coefficient of variation of the aggregate probability distribution, while disagreement is defined as the coefficient of variation of the distribution of point forecasts.