

Box 5

RESULTS OF THE ECB SURVEY OF PROFESSIONAL FORECASTERS FOR THE THIRD QUARTER OF 2014

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the third quarter of 2014. The survey was conducted between 17 and 24 July 2014, and 59 responses were received.¹ The expected path of inflation over the period 2014-16 indicates a moderate pick-up from the current low levels. Compared with the previous round, inflation expectations for 2014 and 2015 were revised downwards slightly to 0.7% and 1.2%, respectively, but were unchanged at 1.5% for 2016. Long-term inflation expectations edged up by 0.02 percentage point to stand at 1.86%. Growth expectations were revised downwards slightly for 2014, but remained unchanged for 2015 and 2016, implying a gradual strengthening of real GDP growth. Unemployment expectations were revised downwards across all horizons.

Inflation expectations revised downwards slightly further for 2014 and 2015 but unchanged for 2016

The SPF average point forecasts for inflation in 2014, 2015 and 2016 stand at 0.7%, 1.2% and 1.5% respectively (see the table). A number of respondents argued that the trough of inflation has more or less been reached, and expect inflation to be on an upward sloping path over the next few years as a result of the recovery in real economic activity and an unwinding of the downward impact of previous oil, food and exchange rate developments. In addition, stable inflation expectations and wage growth, although moderate, are considered to provide a floor to inflation.

¹ The survey 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. 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, Eurosystem staff macroeconomic projections, Consensus Economics and the Euro Zone Barometer

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon			
	2014	2015	2016	Long-term ¹⁾
SPF Q3 2014	0.7	1.2	1.5	1.9
SPF Q2 2014	0.9	1.3	1.5	1.8
Eurosystem staff macroeconomic projections (June 2014)	0.7	1.1	1.4	-
Consensus Economics (July 2014)	0.7	1.2	1.5	1.9
Euro Zone Barometer (July 2014)	0.7	1.2	1.5	1.8
Real GDP growth	2014	2015	2016	Long-term ¹⁾
SPF Q3 2014	1.0	1.5	1.7	1.8
SPF Q2 2014	1.1	1.5	1.7	1.7
Eurosystem staff macroeconomic projections (June 2014)	1.0	1.7	1.8	-
Consensus Economics (July 2014)	1.1	1.6	1.6	1.5
Euro Zone Barometer (July 2014)	1.1	1.6	1.7	1.6
Unemployment rate ²⁾	2014	2015	2016	Long-term ¹⁾
SPF Q3 2014	11.6	11.3	10.8	9.4
SPF Q2 2014	11.8	11.5	11.0	9.5
Eurosystem staff macroeconomic projections (June 2014)	11.8	11.5	11.0	-
Consensus Economics (July 2014)	11.7	11.4	-	-
Euro Zone Barometer (July 2014)	11.7	11.4	11.0	10.3

1) Long-term expectations refer to 2019 (2018 for SPF Q2 2014 and Eurozone Barometer). In the case of Consensus Economics, expectations for 2016 and the long term are taken from the April 2014 survey.

2) As a percentage of the labour force.

Compared with the previous survey round in the second quarter of 2014, there were downward revisions of 0.2 percentage point and 0.1 percentage point respectively for 2014 and 2015, while inflation forecasts for 2016 were unchanged. The main factors cited as being behind the downward revisions compared with the previous survey round were lower than expected actual inflation outcomes, the general disinflationary environment and an ongoing lagged impact of previous exchange rate and commodity price developments, as well as a slightly softer real economic outlook.

Overall, the expected path of inflation for the period 2014-16 in the SPF for the third quarter of 2014 is broadly in line with that of the June 2014 Eurosystem Broad Macroeconomic Projection Exercise, with SPF expectations standing 0.1 percentage point higher for both 2015 and 2016. SPF expectations are exactly in line with the July 2014 Consensus Economics and Euro Zone Barometer surveys.

Turning to the aggregate probability distributions for expected inflation in 2014-16 (see Chart A), the means have moved further towards lower outcomes compared with the previous SPF round, most prominently for 2014 expectations. However, the most likely (modal) outcomes have remained in the same bins (i.e. 0.5%-0.9% for 2014, 1.0%-1.4% for 2015 and 1.5%-1.9% for 2016). According to survey participants, the probability of negative inflation remains very low: 3.1% in 2014, 2.5% in 2015 and 1.2% in 2016. The probability of inflation remaining low (below 1%) is 34% for 2015 and 19% for 2016.

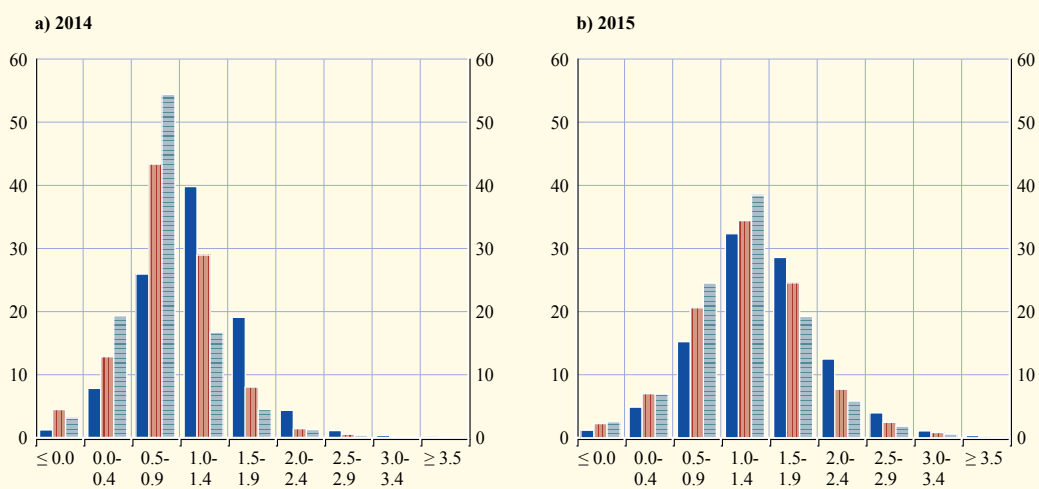
Comparing the estimated mean of the aggregated probability distribution with the average of the point forecasts suggests that the implied risks to the baseline inflation outlook are broadly balanced for 2014 and 2015 and slightly to the downside for 2016.² However, participants' qualitative comments suggest that downside risks are more prominent over the whole period 2014-16,

2 The difference between the mean point estimate and the estimated mean of the aggregated probability distribution can be regarded as an indication of the direction and magnitude of the balance of risks perceived by SPF respondents to their forecasts. For more information on uncertainty measures, see the box entitled "Measuring perceptions of macroeconomic uncertainty", *Monthly Bulletin*, ECB, January 2010.

Chart A Aggregate probability distribution of average annual inflation expectations for 2014 and 2015 in the latest SPF rounds

(probability in percentages)

■ Q1 2014 SPF
 ■ Q2 2014 SPF
 ■ Q3 2014 SPF



Source: ECB.

Note: The aggregate probability distribution corresponds to the average of individual probability distributions provided by respondents to the SPF.

primarily as a result of external developments (mainly energy commodity prices and exchange rates), but also domestic factors (economic activity and the output gap). However, some respondents also mentioned these same factors as upward risks. A small number of respondents mentioned government measures (indirect taxes and administered prices) as an upward risk to inflation.

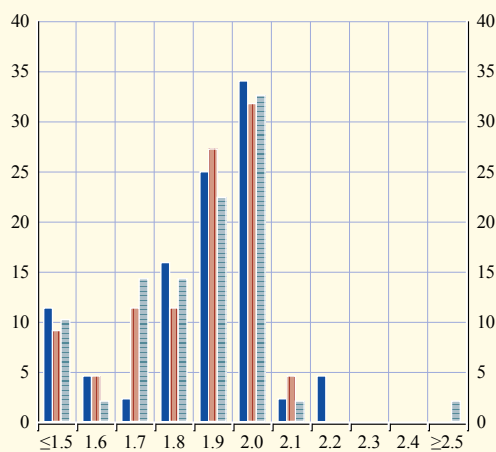
Longer-term inflation expectations broadly unchanged

The average point forecast for longer-term (five years ahead) inflation expectations (2019 in this round; 2018 in the previous round) edged up by 0.02 percentage point to 1.86%. The longer-term inflation expectations of a balanced panel of respondents – who participated in both of the two last rounds – were essentially unchanged at 1.85%. The median of the point forecasts remained at 1.9% for the third consecutive round. As has been the case for the last four years, the largest portion (33%) of respondents provided a point forecast of 2.0% (see Chart B).

Chart B Cross-sectional distribution of longer-term (five years ahead) inflation point forecasts

(percentage of respondents)

■ Q1 2014 SPF
 ■ Q2 2014 SPF
 ■ Q3 2014 SPF



Source: ECB.

The long-term inflation expectations from the SPF are in line with the latest inflation expectations for 2018 from the April 2014 Consensus Economics survey and 0.1 percentage point above those for 2019 from the July 2014 Euro Zone Barometer survey.

The aggregate probability distribution remained broadly unchanged compared with the previous SPF round, both in terms of its mean and the spread of its distribution (dispersion). On average, the balance of risks around the point forecast is assessed to be to the downside (as has been the case for the past four years), with the estimated mean of the aggregated probability distribution standing at around 1.75% compared with the mean point estimate of 1.86%. The probability of inflation being at or above 2.0% declined from 39% to 37% in the second quarter of 2014, while the probability of inflation being below 1% decreased to 11%, down from 12% in the previous round. The probability of negative inflation rates in the longer term remained very low at 0.9% (down from 1.2%).

Disagreement over longer-term inflation expectations, as measured by the standard deviation of the point forecasts, increased substantially compared with the previous round, essentially owing to one large outlier. The aggregate uncertainty surrounding longer-term inflation expectations, as measured by the standard deviation of the aggregate probability distribution, remained largely unchanged (see Chart C).

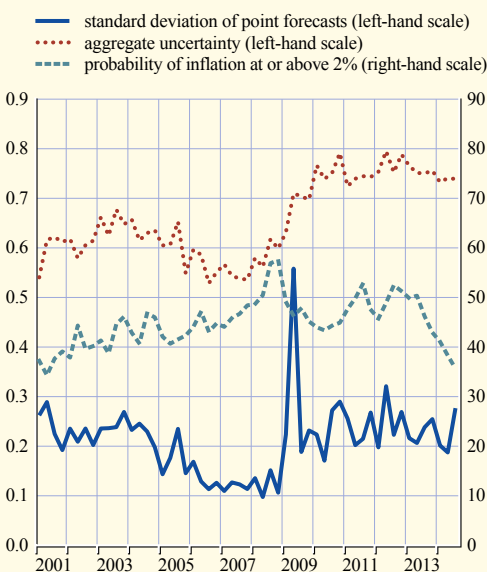
Real GDP growth expectations slightly lower for 2014 and unchanged for 2015 and 2016

The average point forecast for real GDP growth in 2014 decreased slightly by 0.1 percentage point, to 1.0%, and remained unchanged at 1.5% for 2015 and 1.7% for 2016 (see the table). These expectations imply a gradual strengthening of economic activity in the years ahead. The qualitative comments provided by the respondents indicate that the downward revisions for 2014 were driven by a weaker than expected momentum in the second quarter, mainly reflecting lower than envisaged export and private consumption growth.

For 2014 the average SPF point forecast is in line with the June 2014 Eurosystem staff macroeconomic projections, but 0.2 percentage point and 0.1 percentage point lower for 2015 and 2016, respectively. Compared with the July survey results from Consensus Economics and the Eurozone Barometer, the SPF expectations are slightly lower for 2014 and 2015. For 2016 the SPF result is in line with the survey result from Eurozone Barometer and marginally lower than the result from Consensus Economics.

Chart C Disagreement and uncertainty about longer-term inflation expectations

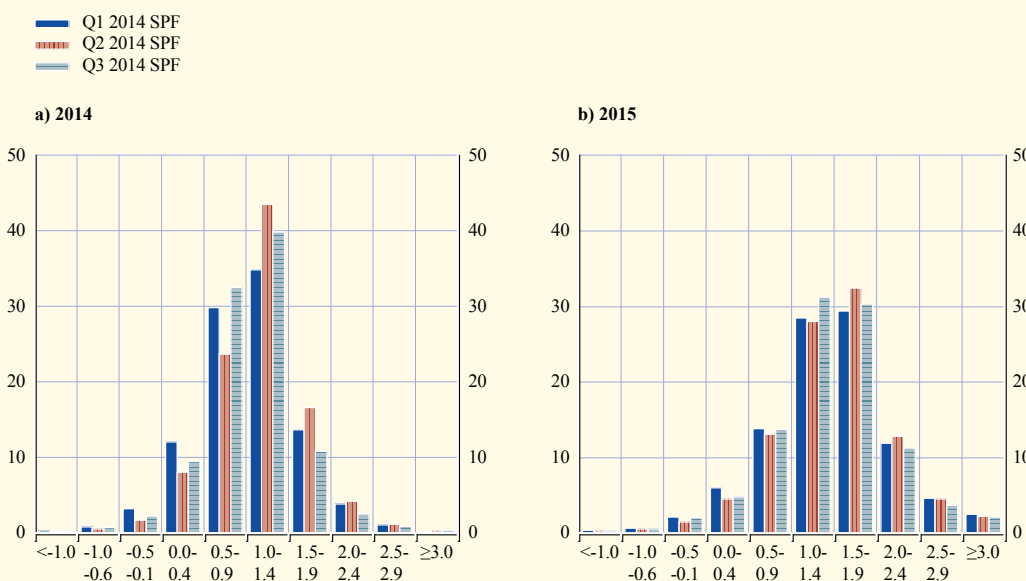
(percentage points; percentages)



Source: ECB.
Note: Aggregate uncertainty is defined as the standard deviation of the aggregate probability distribution (assuming discrete probability density function with probability mass concentrated in the middle of the interval).

Chart D Aggregate probability distribution of GDP growth expectations for 2014 and 2015 in the latest SPF rounds

(probability in percentages)



Source: ECB.

Note: The aggregate probability distribution corresponds to the average of individual probability distributions provided by respondents to the SPF.

The aggregate probability distributions for 2014 and 2015 have shifted towards lower outcomes (see Chart D). For 2014, the highest probability continues to be assigned to the interval between 1.0% and 1.4%: 40% compared with 44% in the previous SPF round. For 2015, too, the highest probability (31%) is assigned to the interval between 1.0% and 1.4% (compared with 28% in the previous round). The aggregate probability distribution for 2016 remained largely unchanged.

The balance of risks around the somewhat lower baseline outlook remains tilted to the downside. According to respondents, these risks are related mainly to the impact of geopolitical tensions such as in Ukraine and the Middle East, as well as lower than expected external demand (mainly from China and the United States).

As in the last round, some respondents referred to the risk that uncertainty in financial markets may rise again and then trickle into the real economy, inter alia through a tightening in credit supply. However, respondents also see some upside risks, such as a quicker return of investor and consumer confidence, and the realisation of the proceeds of structural reforms earlier than assumed in the baseline.

Longer-term growth expectations virtually unchanged

Longer-term growth expectations as measured by the average point forecast (for 2019) stayed virtually constant, but increased by 0.1 percentage point to 1.8% when rounded to the first decimal. As in previous survey rounds, the SPF results for that horizon remain higher than the corresponding Consensus Economics and Euro Zone Barometer forecasts, which stand at 1.5%

and 1.6% respectively. The aggregate probability distribution of long-term growth expectations remains skewed to the downside.

Unemployment rate expectations revised further downwards over the forecast horizon

The average point forecasts for the unemployment rate are 11.6% for 2014, 11.3% for 2015 and 10.8% for 2016. The modest nature of the recovery is seen as reducing unemployment only at a very slow pace and labour market reforms implemented in a number of countries still need time to take full effect. Compared with the previous round, the forecast unemployment rate has been revised downwards by 0.2 percentage point for each year (see the table), and forecasters who commented on the revisions to their unemployment expectations reported that this mainly reflects recent positive surprises from unemployment figures and survey indicators.

The latest SPF expectations for unemployment are more optimistic than other forecasts and projections for all periods: for 2014 and 2015 they are 0.2 percentage point below the June 2014 Eurosystem Broad Macroeconomic Projection Exercise and 0.1 percentage point below the forecasts from Consensus Economics and the Euro Zone Barometer, while SPF expectations for 2016 are 0.2 percentage point below all others.

Risks to the short and medium-term forecasts around the baseline outlook remain tilted to the upside and closely related to the recovery being possibly more modest than anticipated. Additionally, some respondents saw upside risks related to the effects of the minimum wage being introduced in Germany and to the possibility that recent high cyclical unemployment might become structural. Downside risks to the unemployment outlook are mostly associated with stronger than envisaged competitiveness gains resulting from structural and labour market reforms in southern Europe and the EU initiative to support jobs.

The average point forecast for longer-term unemployment rate expectations (9.4% for the new reference year 2019) is 0.1 percentage point lower than in the previous SPF round. The aggregate probability distribution has become more concentrated in the interval between 9.0% and 10.4% (52%) compared with the previous SPF round.

Other variables and conditioning assumptions

According to other information provided by respondents, forecasts for oil prices remained practically unchanged compared with the previous round, with prices expected to remain at around USD 107 per barrel until 2016. The forecast for the euro exchange rate against the dollar is also broadly unchanged, standing at 1.35 in the third quarter of 2014, declining gradually to 1.31 in 2015 and 1.29 in 2016. Similarly, the expected growth in compensation per employee has remained practically unchanged for the short to medium-term horizon, with 1.4% year on year in 2015, 1.6% in 2015 and 1.8% in 2016. For the five-year ahead horizon, forecasters expect a growth rate of 2.2%. The mean assumption for the ECB's main refinancing rate is broadly flat for the next four quarters, implying a marginal downward revision for the short term but a more significant one for the medium term. It is assumed that it will stand at around 0.15% until mid-2015, before increasing slightly to stand at 0.17% for 2015 as a whole and then at 0.35% in 2016.