Box 5

RESULTS OF THE ECB SURVEY OF PROFESSIONAL FORECASTERS FOR THE FIRST QUARTER OF 2009

This box reports the results of the ECB Survey of Professional Forecasters (SPF) for the first quarter of 2009. The survey was conducted between 15 and 21 January 2009. The SPF collects information on expectations for euro area inflation, GDP growth and unemployment from experts affiliated with financial or non-financial institutions that are based in the EU.[1]

Inflation expectations for 2009 and 2010

SPF participants' inflation expectations for 2009 and 2010 have been revised markedly downwards since the previous round (conducted in October) and now stand at 0.9% and 1.6% respectively. The downward revision was largest for 2009, namely 1.3 percentage points (see the table below).[2] Many respondents mentioned the ongoing fall in commodity (energy and food) prices and the weaker than expected economic activity as the factors behind their downward revisions.

The SPF inflation expectations for 2009 and 2010 are below, or at the bottom end of, the ranges reported in the December 2008 Eurosystem staff macroeconomic projections for the euro area (finalised in late November 2008). The SPF inflation expectations are, on average, slightly below those of the January 2009 issues of Consensus Economics and the Euro Zone Barometer (both finalised on 12 January).

SPF participants were also asked to assess the probability of the future outcome falling within specific intervals. The aggregate probability distribution obtained by averaging the forecasters'

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

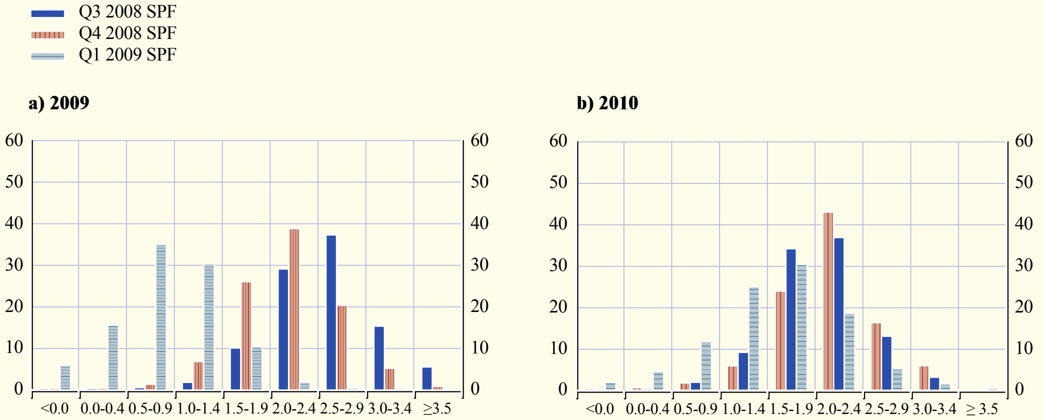
(annual percentage changes, unless otherwise indicated)

	Survey horizon				
HICP inflation	**2009**	**December 2009**	**2010**	**December 2010**	**Longer term 2)**
SPF Q1 2009	0.9	1.4	1.6	1.7	1.9
Previous SPF (Q4 2008)	*2.2*	-	*2.0*	-	*2.0*
Eurosystem staff macroeconomic projections	1.1 - 1.7	-	1.5 - 2.1	-	-
Consensus Economics (January 2009)	1.0	-	1.7	-	2.0
Euro Zone Barometer (January 2009)	1.0	-	1.6	-	2.1
Real GDP growth	**2009**	**Q3 2009**	**2010**	**Q3 2010**	**Longer term 2)**
SPF Q1 2009	-1.7	-1.8	0.6	0.9	2.0
Previous SPF (Q4 2008)	*0.3*	-	*1.4*	-	*2.0*
Eurosystem staff macroeconomic projections	-1.0 - 0.0	-	0.5 - 1.5	-	-
Consensus Economics (January 2009)	-1.4	-	0.8	-	2.0
Euro Zone Barometer (January 2009)	-1.5	-	0.9	-	2.2
Unemployment rate 1)	**2009**	**November 2009**	**2010**	**November 2010**	**Longer term 2)**
SPF Q1 2009	8.7	9.1	9.4	9.4	7.8
Previous SPF (Q4 2008)	*8.0*	-	*8.1*	-	*7.1*
Consensus Economics (January 2009)	8.5	-	9.1	-	-
Euro Zone Barometer (January 2009)	8.6	-	9.2	-	8.3

1) As a percentage of the labour force.
2) Longer-term inflation expectations in the SPF, the Euro Zone Barometer and Consensus Economics refer to 2013 .

Chart A Probability distribution for average annual inflation in 2009 and 2010 in the latest SPF rounds [1)]

(probability in percentages)



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

responses provides a summary of their assessments. It also provides information about how, on average, survey participants gauge the risk of the actual outcome being above or below the most likely range. Reflecting the lower point estimates, the probability distributions associated with the forecast outcomes were revised heavily downwards for both 2009 and 2010, with the largest revision being made for 2009 (see Chart A). The probability distribution for both years shifted towards lower outcomes in comparison with the previous SPF, and only a small probability is now associated with outcomes being above 2% (about 3% for 2009 and 26% for 2010). Overall, the balance of risks to the forecasts is assessed by respondents to be on the downside, although some respondents cite commodity prices as an upward risk in the second half of 2009 and in 2010.

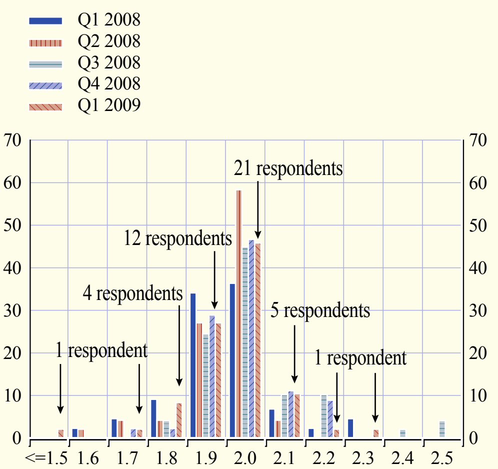
Indicators of longer-term inflation expectations

Longer-term inflation expectations (for the year 2013) were revised slightly downwards, from 1.99% to 1.94%. These point expectations are below those in the latest long-term inflation projections provided by Consensus Economics in October 2008 and the Euro Zone Barometer in January 2009 by 0.1 and 0.2 percentage point respectively.

Consistent with the downward revision in average point expectations, the probability of longer-term inflation standing at 2% or above decreased to 49%, according to survey respondents (see Chart B). These survey results can be compared with the break-even inflation rate, an indicator of longer-

Chart B Cross-sectional distribution of longer-term (five years ahead) inflation expectations among SPF respondents

(percentage of respondents)

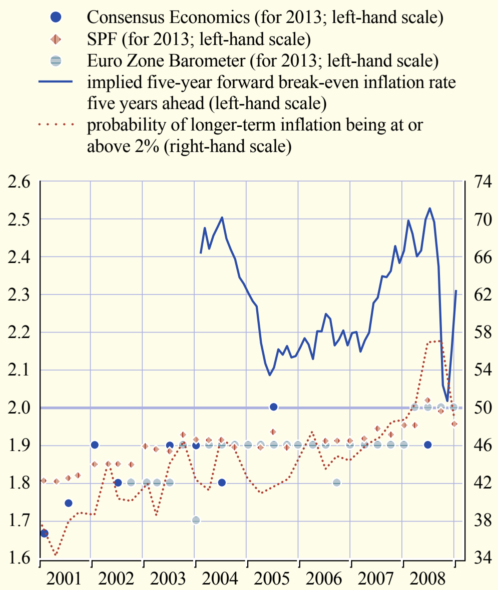


Source: ECB.

term inflation expectations among market participants calculated as the yield spread between nominal and inflation-linked bonds.[3] Until recently, movements in the probability assigned to an outcome that inflation will stand at 2% or above in the next five years were, on average, broadly in line with developments in financial market-based indicators of inflation expectations (e.g. the seasonally adjusted implied five-year forward break-even inflation rate five years ahead) (see Chart C).[4] For instance, both showed an upward tendency from early 2007 to the middle of 2008. However, since September and the further intensification of financial market turmoil, financial market-based inflation expectations have been somewhat erratic and may have been distorted due to investors' efforts to reduce risk and leverage and their strong preference for more secure and liquid assets.[5]

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

SPF respondents have revised their growth expectations for 2009 downwards to an unprecedented degree and now expect euro area economic activity (real GDP) to contract by 1.7% in 2009. This represents a further significant downward revision to their growth assessments for 2009 (the downward revision of 2.0 percentage points since the last round is by far the largest since the launch of the SPF in 1999 – double the previous "record" established in the SPF round for the fourth quarter of 2008). Respondents also revised their growth expectations for 2010 downwards substantially, by 0.8 percentage point to 0.6%. Since July 2008, SPF respondents have revised the growth forecast for the period 2009-2010 down by a cumulative 4 percentage points.

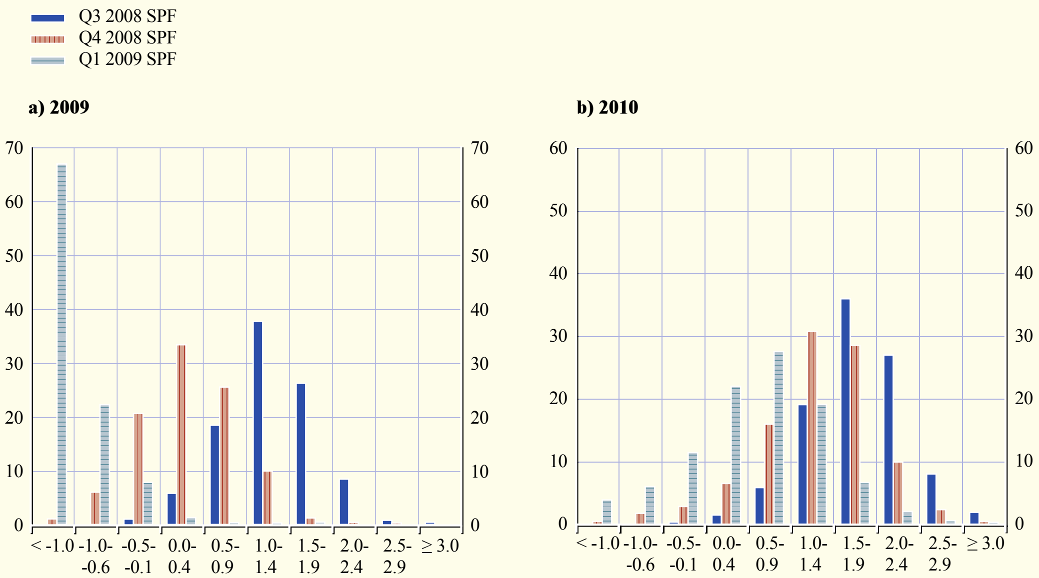
According to the qualitative explanations provided by approximately half the respondents, while many cited the financial market turmoil as a factor behind the slowdown, the downturn is now assessed to be widespread and impacting on all parts of the economy. However, there are some factors that SPF respondents believe will support economic activity. First, falls in commodity prices will increase consumers' real incomes. Second, already announced monetary and fiscal policy measures are expected to boost activity.

The SPF growth expectations for 2009 are considerably below the range reported in the December 2008 Eurosystem staff macroeconomic projections for the euro area, while those for 2010 are at the bottom end of the range. In addition, the SPF forecasts are also somewhat

3 See also the article entitled "Measures of inflation expectations in the euro area" in the July 2006 issue of the Monthly Bulletin.
4 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).
5 For a further discussion of the impact of the current financial market turmoil 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" in the November 2008 issue of the Monthly Bulletin.

Chart D Probability distribution for average annual real GDP growth in 2009 and 2010 in the latest SPF rounds [1)]

(probability in percentages)



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

lower than those reported in the January releases of Consensus Economics and the Euro Zone Barometer.

In line with the downward revision of expected real GDP growth for 2009, the aggregate probability distribution for 2009 has also been revised down substantially (see Chart D). The scale of the downward revision is evident from the fact that the largest probability is associated with outcomes in the open-ended interval (less than -1%).

For 2010, the aggregate probability distribution has also shifted towards lower outcomes. Respondents have assigned a 50% probability that real GDP growth will be in the range from 0.0% to 1.0%. Furthermore, the balance of risks is assessed to be slightly to the downside, with the estimated mean of the probability distribution (at around 0.5%) below the average of the reported point estimates (0.6%). Many of the forecasters stress the great uncertainty surrounding the possible timing and sources of a recovery. As reported in the previous round, uncertainty derived from the aggregate probability distribution surrounding two-years-ahead (with reference to the latest available data point) real GDP forecasts has increased substantially since the beginning of 2008, and reached a new peak in this round.

SPF respondents were also explicitly asked to specify when they expected the recovery (i.e. sustained and positive growth) in economic activity to start. Approximately 50% of those responding expect the recovery to take place during the second half of 2009, with many of these respondents specifying that it would set in towards the end of 2009 at the earliest. Approximately one-third gave the first half of 2010, while the remainder indicated the second half of 2010 or later.

Longer-term growth expectations (for 2013), at 2.0%, remained unchanged. Overall, respondents assess the balance of risks to be on the downside. SPF forecasters have assigned a higher probability to longer-term real GDP growth being within the 1.5% to 1.9% interval than to it being in the 2.0% to 2.4% interval.

Expectations for the euro area unemployment rate

Consistent with the major downward revisions to their growth expectations, SPF respondents revised their unemployment rate expectations substantially upwards for all horizons. Given the somewhat lagging relationship between growth and unemployment, the upward revision was largest for 2010 (by 1.3 percentage points to 9.4%), while the revision for 2009 was 0.7 percentage point to 8.7%. Longer-term unemployment rate expectations were also revised significantly upward, by a relatively large amount (0.7 percentage point), and now stand at 7.8%. The profile of unemployment expectations reported by SPF respondents implies that the unemployment rate is only expected to return to the current rate of 7.8% after five years. This underscores both the severity and length of the downturn anticipated and the considerable degree of hysteresis respondents still perceive in European labour markets.

In their qualitative explanations, forecasters mainly commented on short-term labour market prospects. Many respondents stated that the upward revision to forecast unemployment would have been larger and more prolonged were it not for the increased flexibility afforded by past structural reforms in the labour market. A number of them also explicitly mentioned that the decline expected in unemployment rates after 2010 is conditional on the pace of labour market reform being stepped up and not being halted or reversed owing to the current adverse environment.