EUROPEAN CENTRAL BANK

EUROSYSTEM

The ECB Survey of Professional Forecasters

Second quarter of 2018

April 2018

Contents

The results of the ECB Survey of Professional Forecasters (SPF) for the second quarter of 2018 show average inflation expectations of 1.5%, 1.6% and 1.7% for 2018, 2019 and 2020, respectively.[1] This near-term profile is a little weaker than that reported for the previous quarter. Average longer-term inflation expectations (which refer to 2022) remained at 1.9%. Expectations for real GDP growth stood at 2.4%, 2.0%, and 1.6% for 2018, 2019 and 2020, respectively. Expectations for real GDP growth in the longer term remained at 1.6%. Unemployment rate expectations were again revised down across horizons.

Table 1

Results of the SPF in comparison with other expectations and projections

(annual percentage changes, unless otherwise indicated)

	Survey horizon			
	2018	2019	2020	Longer term[1)]
HICP inflation				
Q2 2018 SPF	1.5	1.6	1.7	1.9
Previous SPF (Q1 2018)	1.5	1.7	1.8	1.9
ECB staff macroeconomic projections (March 2018)	1.4	1.4	1.7	-
Consensus Economics (April 2018)	1.5	1.5	1.7	1.9
Euro Zone Barometer (April 2018)	1.5	1.6	1.8	1.9
Memo: HICP inflation excluding food and energy				
Q2 2018 SPF	1.2	1.5	1.7	1.8
Previous SPF (Q1 2018)	1.2	1.5	1.7	1.8
ECB staff macroeconomic projections (March 2018)	1.1	1.5	1.8	-
Real GDP growth				
Q2 2018 SPF	2.4	2.0	1.6	1.6
Previous SPF (Q1 2018)	2.3	1.9	1.7	1.6
ECB staff macroeconomic projections (March 2018)	2.4	1.9	1.7	-
Consensus Economics (April 2018)	2.4	1.9	1.4	1.5
Euro Zone Barometer (April 2018)	2.3	2.0	1.6	1.4
Unemployment rate[2)]				
Q2 2018 SPF	8.3	7.9	7.5	7.4
Previous SPF (Q1 2018)	8.4	7.9	7.6	7.5
ECB staff macroeconomic projections (March 2018)	8.3	7.7	7.2	-
Consensus Economics (April 2018)	8.3	7.9	-	-
Euro Zone Barometer (April 2018)	8.3	7.8	7.5	7.2

1) Longer-term expectations refer to 2022.
2) As a percentage of the labour force.

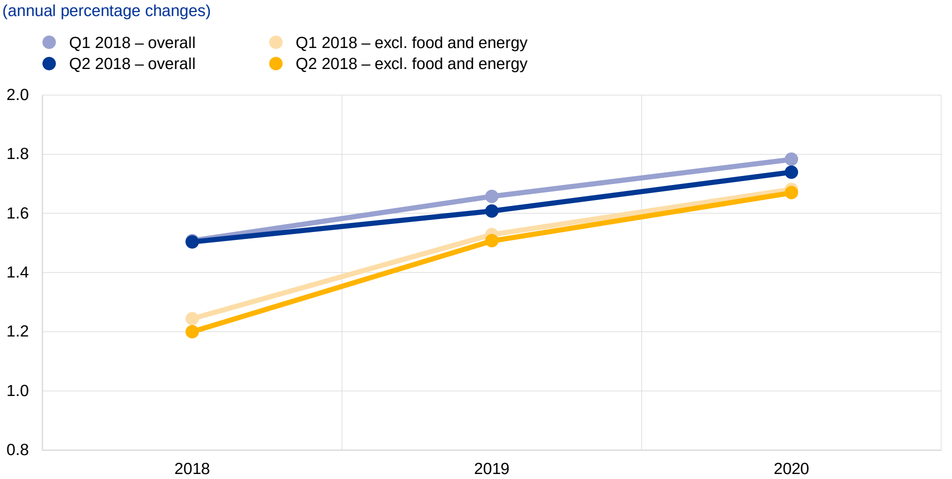
[1] The survey was conducted over 4–10 April. The total number of responses was 58. The survey requested information on expectations for the euro area HICP inflation rate (overall and excluding food and energy), the real GDP growth rate and the unemployment rate for 2018, 2019, 2020 and 2022, as well as for each of these variables one and two years ahead, with respect to the latest available data point. Participants were provided with a common set of the latest available data for annual HICP inflation (March 2018 flash estimates: overall inflation, 1.4%; excluding food and energy 1.0%), annual GDP growth (Q4 2017, 2.7%) and unemployment (February 2018, 8.5%).

1 Both HICP inflation and HICP excluding food and energy inflation expected to pick up steadily over the period 2018-20

The results of the survey for the second quarter of 2018 show average inflation expectations of 1.5%, 1.6% and 1.7% for 2018, 2019 and 2020, respectively (see Chart 1). Compared with the previous survey, this represents downward revisions of 0.1 percentage points (p.p.) for 2019 and 2020, while expectations for 2018 were unchanged. The SPF inflation profile for the period 2018-20 is comparable with the expectations reported in other surveys, i.e. within 0.1 p.p. of those figures (see Table 1).

Average expectations for inflation excluding food and energy were 1.2%, 1.5% and 1.7% for 2018, 2019 and 2020, respectively. This profile is essentially unchanged from that reported in the previous survey.

Chart 1
Inflation expectations: overall HICP and HICP excluding food and energy



The probability distributions for inflation at the different horizons are narrower than at the time of the previous survey, indicating a further reduction in uncertainty. The probabilities assigned to inflation outcomes greater than 1% but less than 2% increased for 2018, 2019 and 2020. This was largely counterbalanced by a reduction in the probabilities assigned to inflation outcomes of 2% or higher, but there was also a slight reduction in the probabilities given to outcomes of less than 1%. Less than 1% probability was assigned to deflation outcomes in 2018, 2019 and 2020 (see Charts 2-4).

Chart 2
Aggregate probability distribution for inflation expectations for 2018

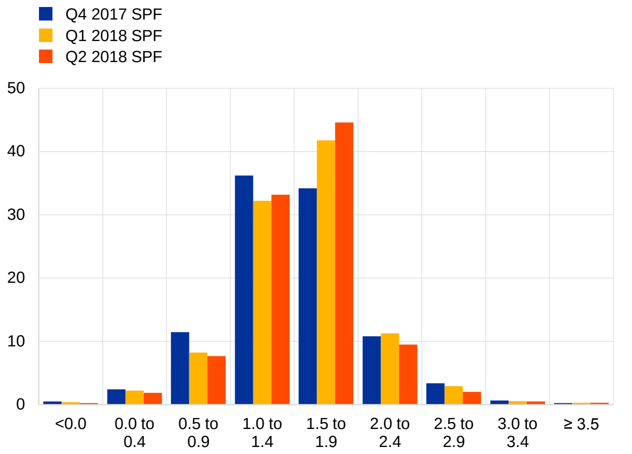


Chart 3
Aggregate probability distribution for inflation expectations for 2019

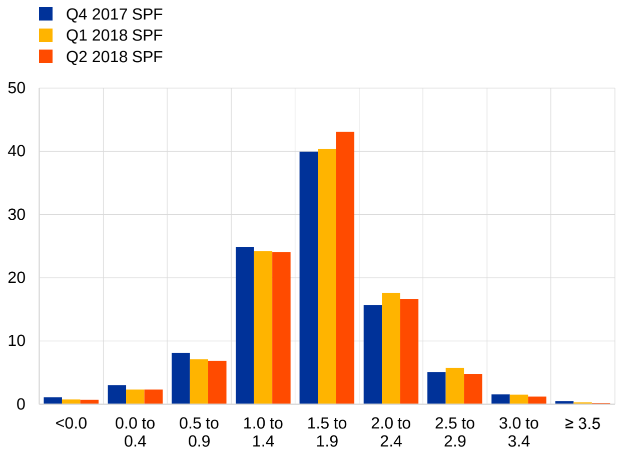
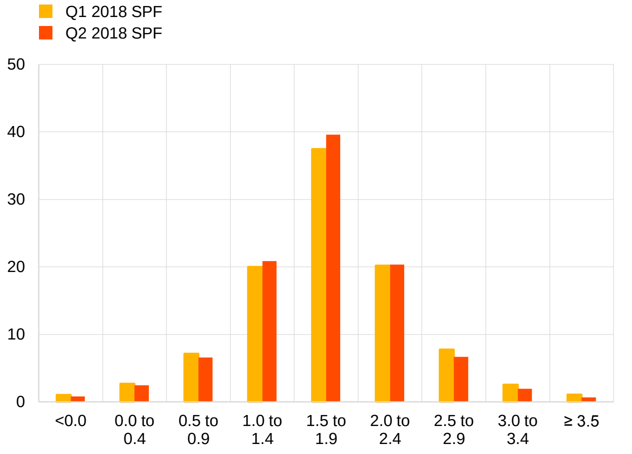


Chart 4
Aggregate probability distribution for inflation expectations for 2020



The expected pick-up in HICP inflation excluding energy and food was in turn supported by expectations of a pick-up in labour cost growth. This survey invited respondents to elaborate on their expectations for growth in compensation per employee and how they expected this to be passed through to consumer prices. On average, annual growth in compensation per employee was expected to increase to 2.3% by 2020 and remain at that rate in the longer term (see panel (d) of Chart 16). Respondents saw this expected increase in labour cost growth, particularly over 2019, as reflecting the waning of earlier drags, for example labour market slack, which included forms of slack such as involuntary part-time working and which may have been underestimated, as well as the lagged effect of past low inflation, which was thought to have weighed on subsequent wage negotiations. Forecasters also emphasised heterogeneity not only across countries, with some countries being at a more advanced stage of cyclical recovery, but also across economic sectors, to the extent that skills shortages differed.

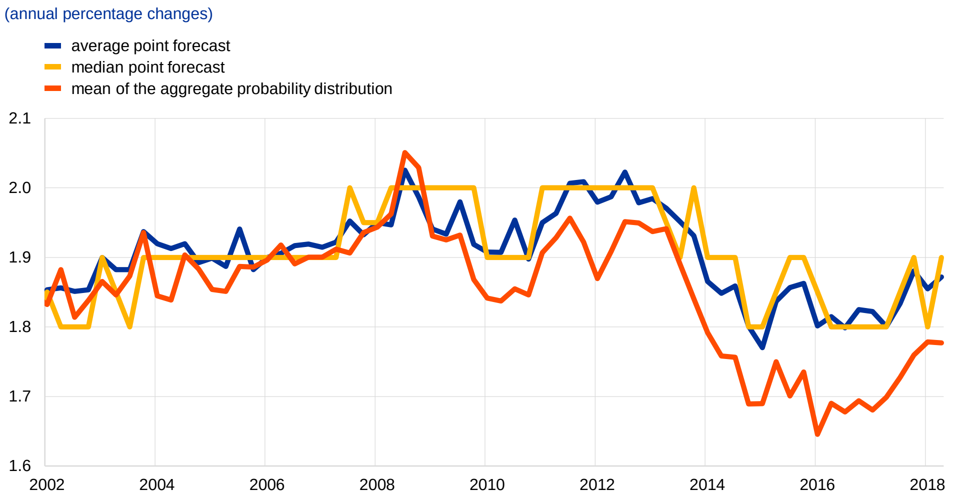
This likely impact of the expected increase in labour cost growth on HICP inflation was considered to be in line with historical relationships, although views on the risks to this pass-through were mixed. The increase in labour cost growth was widely expected to support the pick-up in inflation, acting in particular through services inflation. Those respondents who explicitly referred to historical wage-price pass-through still considered the historical relationship to be a good guide to inform their central expectations. Regarding risks, however, some respondents saw the risk as faster than usual pass-through, given the robust growth in demand, while for others, the main risk was a slower than usual pass-through on account of ongoing competitive pressures.

2 Longer-term inflation expectations unchanged at 1.9%

The average point forecast for longer-term inflation expectations remained unchanged at 1.9%. The median point forecast ticked back up to 1.9%, whereas the mean of the aggregate expected probability distribution remained unchanged (see Chart 5). Overall, these three measures indicate that longer-term inflation expectations have recovered somewhat from the low rates recorded in 2016, but have not yet fully returned to their pre-crisis rates.

Chart 5

Longer-term inflation expectations



The proportion of forecasters reporting longer-term expectations in the range 1.8%-2.0% increased. That, however, was counterbalanced by similar reductions in the proportions of professional forecasters reporting point forecasts of either 2.1% and above, or 1.7% and below (see Chart 6).

The probability assigned to low inflation outcomes decreased. The probability assigned to an outcome in the range 1.5% to 1.9% increased. This was largely matched by a reduction in the probabilities assigned to outcomes below 1.5% (see Chart 7).

Chart 6

Distribution of point expectations for HICP inflation in the longer term

(percentages of respondents)

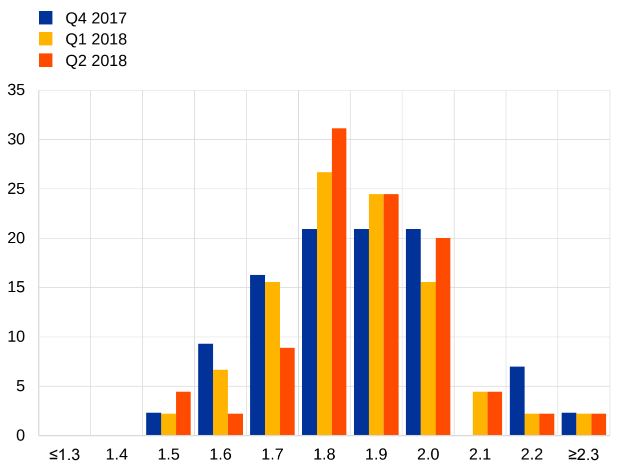
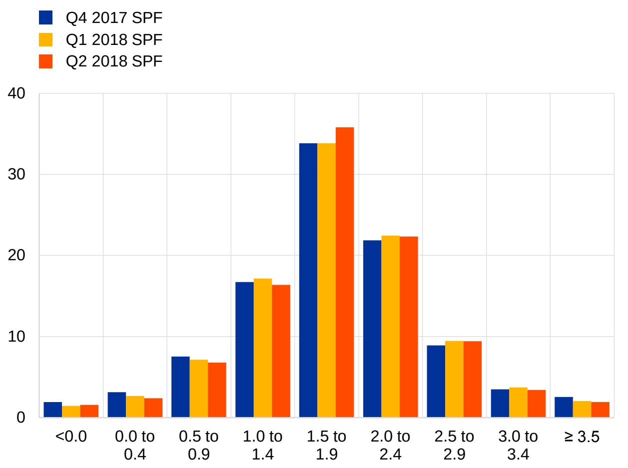


Chart 7

Aggregate probability distribution of longer-term inflation expectations



The perceived balance of risks to inflation expected in the longer term remained to the downside. The asymmetry of a forecast distribution is indicative of the balance of risks that the forecast embodies. In the context of the SPF, where probabilities are reported for discrete intervals, there are a number of alternative ways of measuring asymmetry. Furthermore, because the point forecast is reported separately from the distribution in the SPF, these two pieces of information can be combined to derive a further indicator of the balance of risks, calculated as the mean of the aggregate probability distribution minus the average point forecast. These different measures all continued to point to a balance of risks that is to the downside.[2]

3 Real GDP growth expectations revised up for 2018 and 2019, but down for 2020

Expectations for real GDP growth in 2018, 2019 and 2020 stood at 2.4%, 2.0%, and 1.6%, respectively. That implies upward revisions of 0.1 p.p. for 2018 and 2019 and a downward revision of 0.1 p.p. for 2020. Longer-term growth expectations continued to stand at 1.6%. Qualitative comments on revisions were mostly provided by respondents who had revised their forecasts upwards. One commonly cited reason for their near-term upward revisions was the fact that indications of sentiment had not only remained strong, despite recent negative data news, but had even become more synchronised across euro area countries.

There was a variety of movements in the probability distributions across the different horizons. Consistent with the pattern of revisions seen for the point

2 For further information, see the box entitled "How do professional forecasters assess the risks to inflation?", *Economic Bulletin*, Issue 5, ECB, 2017.

forecasts, the probability distributions for 2018 and 2019 moved towards higher real GDP growth outcomes, whereas for 2020 they moved towards lower growth outcomes (see Charts 8 to 10). At the longer-term horizon, the probability mass shifted a little further to the right, with the probability of growth outturns of over 1.5% standing at 63%, up from 61% in the first quarter of 2018 (see Chart 11).

Risks to real GDP growth were seen as being to the downside in the near term, but broadly balanced beyond that. This was suggested by both quantitative measures of the risk balance and respondents' qualitative comments. For example, for the 2018 horizon, the mean of aggregate probability distribution was 0.1 p.p. below the average point forecast, signifying some downside risk, while for the longer-term horizon both the distribution mean and the point forecast were 1.6%, indicating balanced risks. This result is unchanged from the previous survey, which also reported balanced risks at this horizon, corroborating the view that the latest weak data have not affected professional forecasters' views on the longer term. Although many respondents mentioned downside risks in their qualitative comments, upside risks were also identified, while some explicitly stated that they saw the risks as balanced. The key downside risk was considered to be that world trade could be adversely affected by more restrictive trade policies, which could also have an indirect impact via lower sentiment leading to lower investment. Upside risks included the possibility that external demand could actually turn out stronger than expected, despite the increasing trade tensions, partially through economic stimulus in the US from the latest tax reforms, as well as stronger growth momentum in emerging markets.

Chart 8

Aggregate probability distribution for GDP growth expectations for 2018

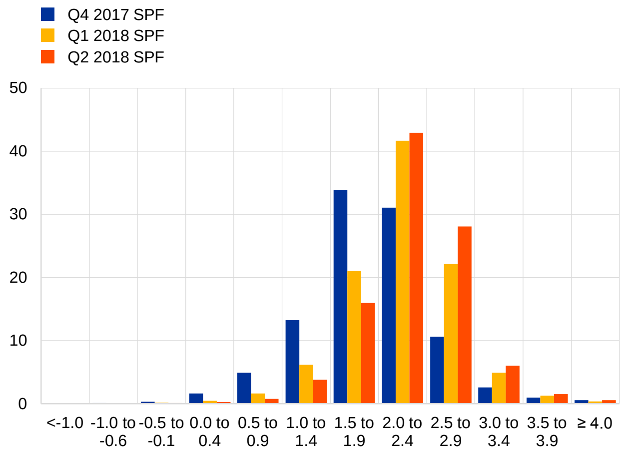


Chart 9

Aggregate probability distribution for GDP growth expectations for 2019

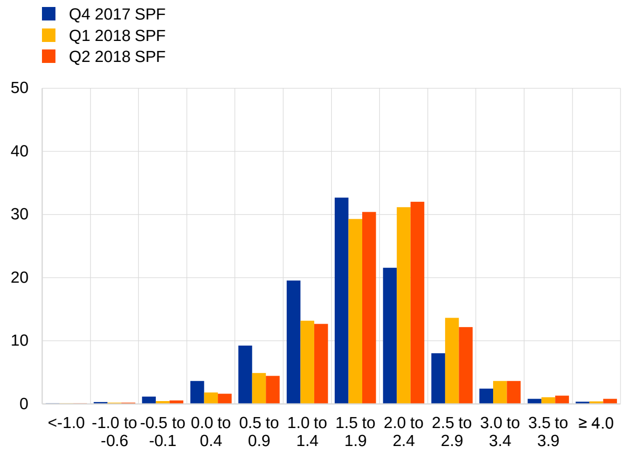


Chart 10

Aggregate probability distribution for GDP growth expectations for 2020

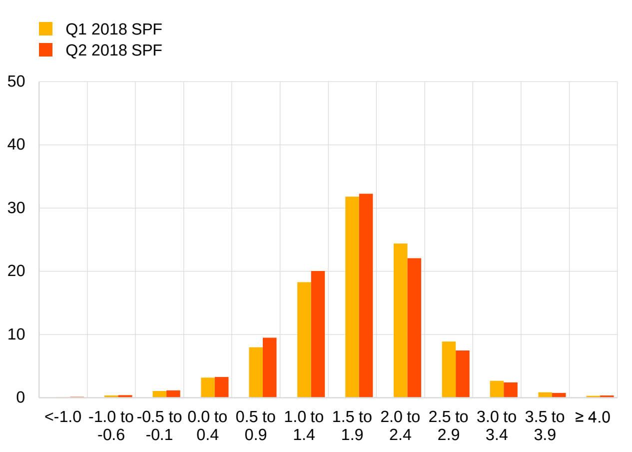
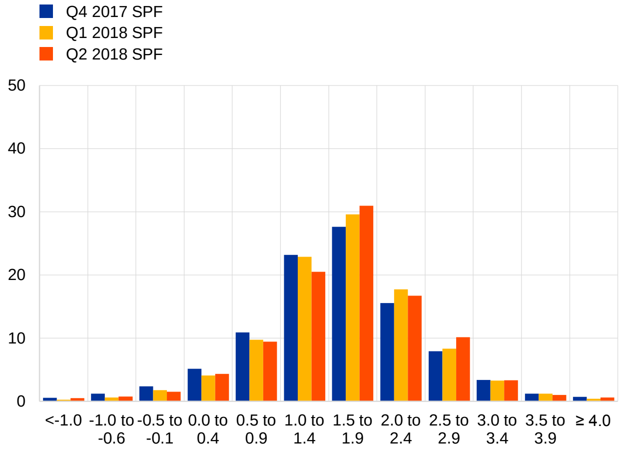


Chart 11

Aggregate probability distribution for longer-term GDP growth expectations



4 Unemployment rate expectations revised downwards again across horizons

Expectations for the unemployment rate in 2018, 2019 and 2020 were, on average, 8.3%, 7.9% and 7.5% respectively. This implies downward revisions of 0.1 p.p. for 2018 and 2020. To two decimal places, however, the magnitude of the downward revisions was similar at all three horizons. According to the qualitative explanations provided by forecasters, the downward revisions to the unemployment rate mainly reflected stronger near-term economic growth expectations, but some respondents mentioned a possible slowdown in the pace of decline of unemployment rate due to an increase in skill mismatch. The aggregate probability distributions also shifted towards lower unemployment rate outcomes (see Charts 12 to 14).

Longer-term unemployment rate expectations were revised downwards by 0.1 p.p. to 7.4%. The point forecast is at the lowest level seen since 2012, although it is still above average pre-crisis expectations (of around 7%). The balance or risks to the longer-term unemployment rate remained tilted towards higher unemployment rate outcomes, although to a lesser extent than in recent surveys (see Chart 15).

Risks were considered to be balanced in the near term, but to the upside further out. The aggregate probability distributions were increasingly skewed towards higher unemployment rate outcomes, which indicates an upside balance of risks, as the forecast horizon lengthened. Quantitatively, the mean of the aggregate probability distribution for 2018 was in line with the average point forecast, whereas for the longer-term horizon the mean of the aggregate probability distribution was 0.2 p.p. higher than the average point forecast.

Chart 12

Aggregate probability distribution for the unemployment rate for 2018

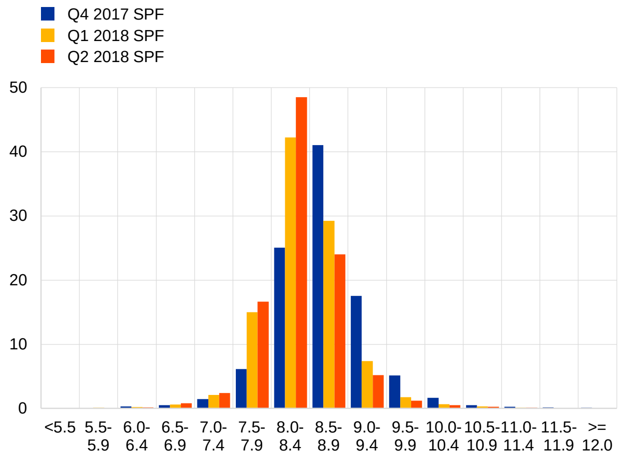


Chart 13

Aggregate probability distribution for the unemployment rate for 2019

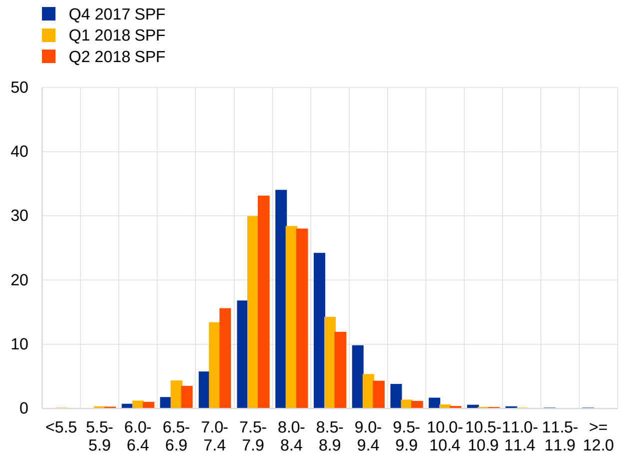


Chart 14

Aggregate probability distribution for the unemployment rate for 2020

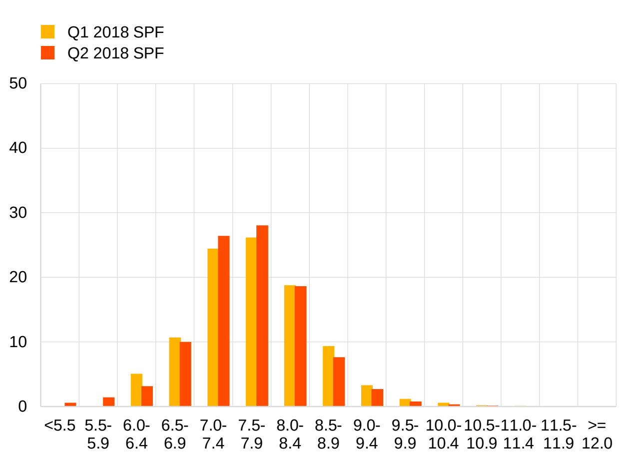
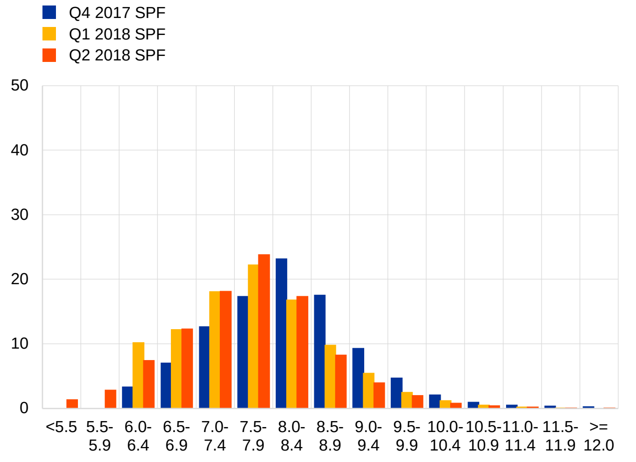


Chart 15

Aggregate probability distribution for the unemployment rate in the longer term



5 Other variables and conditioning assumptions

Respondents' average expectations were for: (i) US dollar-denominated oil prices to decrease slightly over 2018 but thereafter to increase; (ii) the exchange rate of the euro against the US dollar to strengthen this year; (iii) the ECB's main refinancing rate to stay at zero into 2019; and (iv) labour cost growth to increase slowly until 2020, before levelling off.

The mean assumption for the ECB's main refinancing rate was that it would remain at around 0% throughout 2018, before increasing a little to stand at 0.19% in 2019 and 0.66% in 2020 (see panel (a) of Chart 16). This profile is very similar to those reported in the previous two surveys.

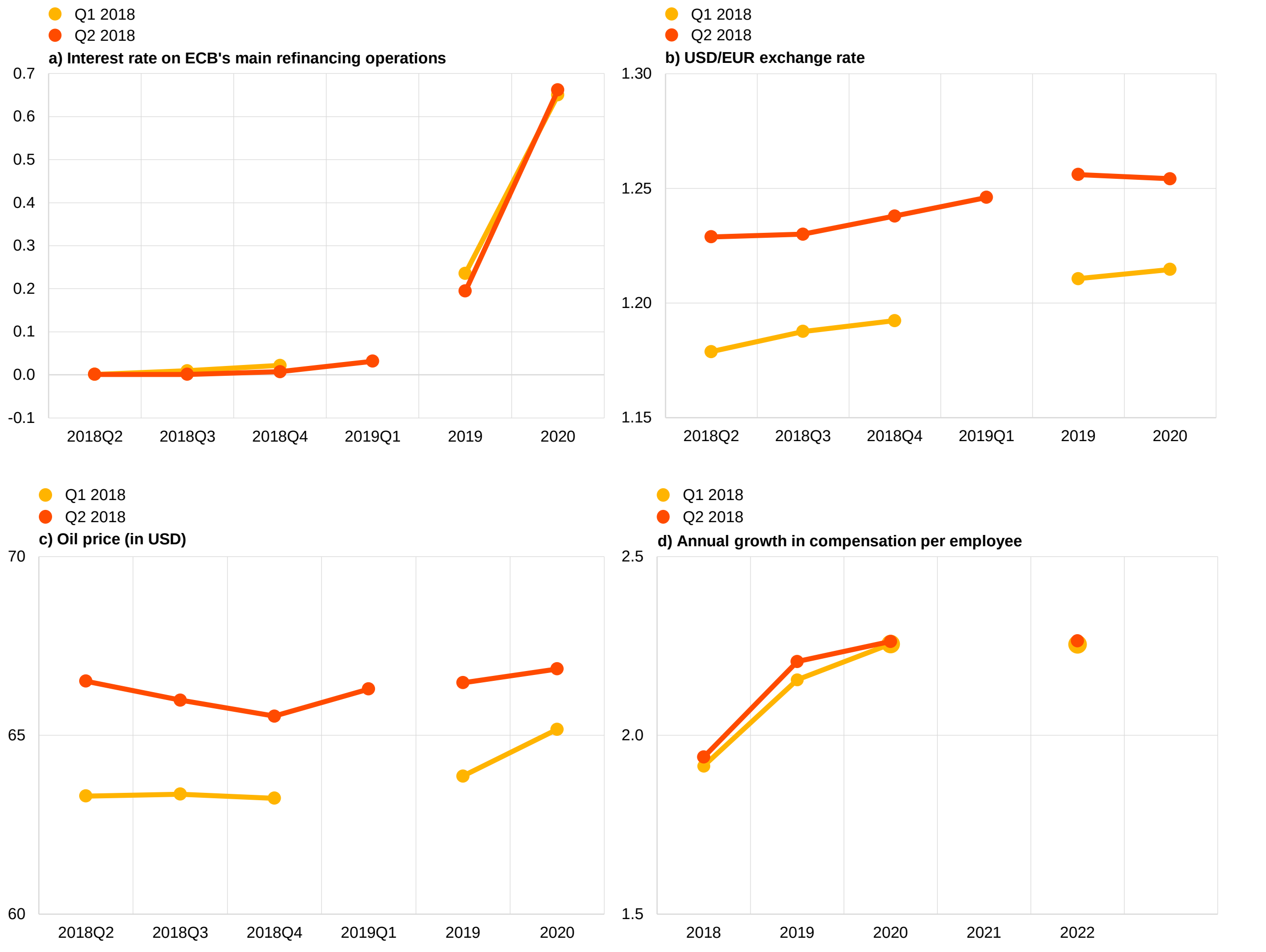
The expected path of the USD/EUR exchange rate is higher relative to that reported in the previous survey, yet the forward dynamics of a steady yet gradual strengthening of the euro are similar (see panel (b) of Chart 16).

US dollar-denominated oil prices were expected to average $66 for both 2018 and 2019 and $67 for 2020. This implies that forecasters expected prices to be between 2.6% and 5.1% higher than they did in the previous survey (see panel (c) of Chart 16). However, when combined with USD/EUR exchange rate expectations, which are between 3.3% and 4.3% stronger than in the previous survey, the implied profile for the oil price expressed in euro terms was little changed.

On average, the profile of the annual growth in compensation per employee was 1.9% for 2018, 2.2% for 2019, and 2.3% for both 2020 and 2022, largely unchanged relative to the previous survey (see panel (d) of Chart 16).

Chart 16

Underlying assumptions



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