

Anchoring long-run inflation expectations in a panel of professional forecasters

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Long-run inflation expectations by professional forecasters

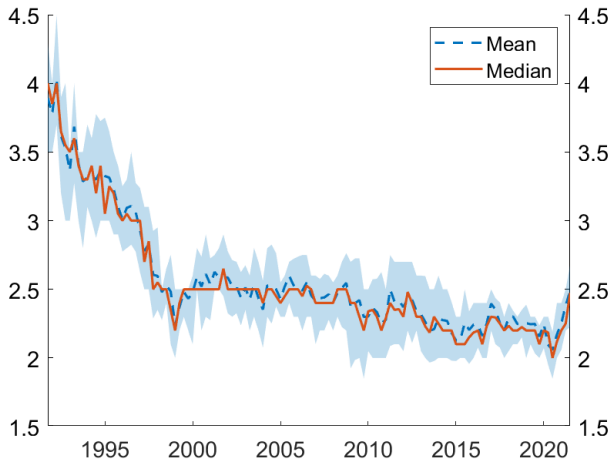


Figure: 10-year CPI inflation expectations, US SPF

Looking behind average expectations

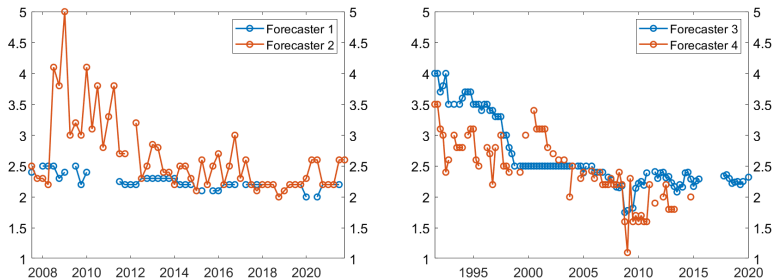


Figure: Long-run inflation expectations by selected forecasters

- ▶ Heterogeneous pattern → importance of looking at **individuals' expectations** to understand behaviour of inflation expectations

This paper

- ▶ Model to explain fluctuations in **aggregate and individual** forecasters' long-run inflation expectations
 - Inflation follows a trend-cycle process
 - Forecasters form long-run inflation expectations based on
 1. Current **inflation**
 2. **News** about trend/long-run inflation:
 - a) **Fundamental** changes in trend inflation
 - b) Common or idiosyncratic **beliefs**
- ▶ Bayesian estimation using **panel data** from US SPF
- ▶ Key questions:
 1. **Sensitivity** of forecasters' expectations to different factors
 2. **Historical drivers** of changes in long-run inflation expectations
 3. **(Re-)Anchoring** US inflation expectations
 - A US central banker in September 2021

Forecasters' sensitivity to inflation and news

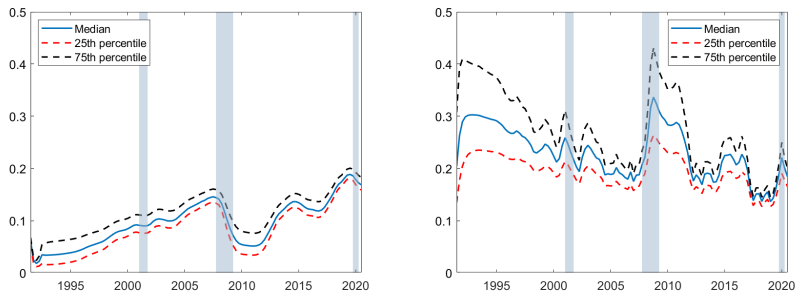


Figure: Kalman gains for the inflation drift due to the **inflation** (lhs) and **news** (rhs) signals

Notes: Shaded areas indicate NBER recession dates.

- ▶ Inflation expectations are not very sensitive to changes in short-run **inflation**

Historical drivers of long-term inflation expectations

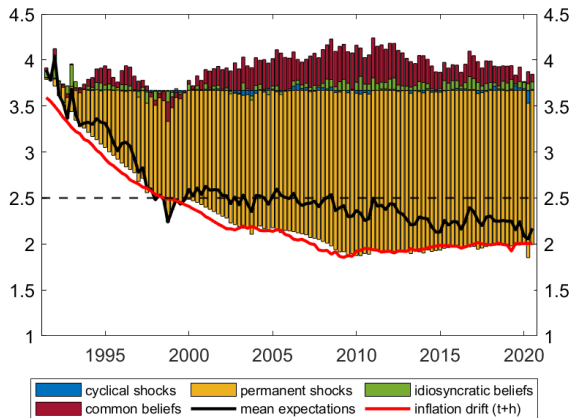


Figure: Historical decomposition of average inflation expectations

- ▶ **News** coordinating **beliefs** (=common beliefs) keeps average inflation expectations anchored for longer despite persistently low inflation

Re-Anchoring US Inflation Expectations

Context:

- ▶ Average CPI long-run inflation expectations reached level of 2.5% in second half of 2021
- ▶ New long-run framework by FOMC (August 2020):
Anchoring expectations by over/undershooting inflation target

⇒ A US central banker in September 2021:

What is the **path of inflation** that would (re-)anchor average expectations at pre-Great Recession level of 2.5% from 2022?

Re-Anchoring US Inflation Expectations

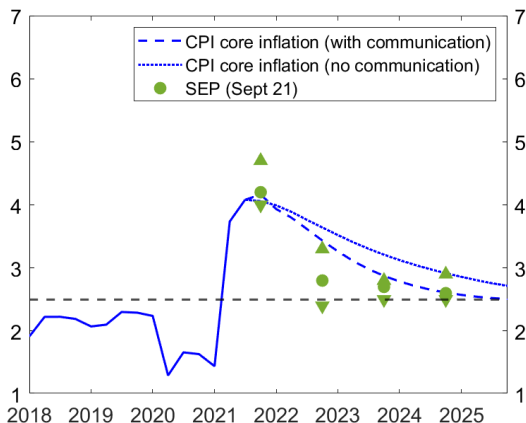


Figure: Inflation path consistent with re-anchoring average long-term inflation expectations at 2.5 percent from 2021Q4

- ▶ SEP inflation overshooting in September 2021 would have not been enough to re-anchor expectations

Conclusion

This paper: How to use panel survey data to

- ▶ estimate sensitivity of long-run inflation expectations
- ▶ assess how much inflation to tolerate to re-anchor expectations

Key take-aways:

1. Inflation expectations are not very sensitive to changes in short-run **inflation**
2. **News** coordinating **beliefs** (=common beliefs) keeps average inflation expectations anchored despite persistently low inflation
3. SEP inflation overshooting in September 2021 would have not been enough to re-anchor expectations

Thank you!