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!