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

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Long-run inflation expectations by professional forecasters

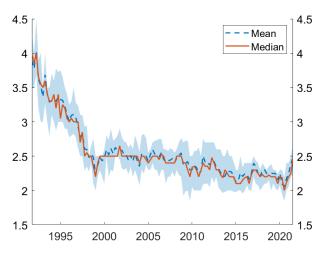


Figure: 10-year CPI inflation expectations, US SPF

Looking behind average expectations

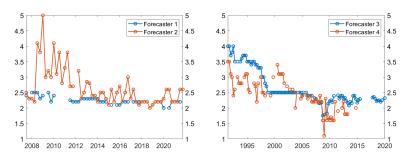


Figure: Long-run inflation expectations by selected forecasters

► 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
 - \rightarrow A US central banker in September 2021

Forecasters' sensitivity to inflation and news

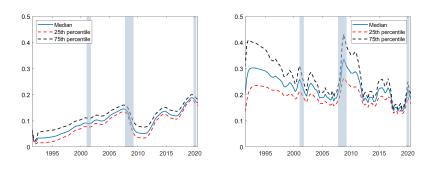


Figure: Kalman gains for the inflation drift due to the inflation (lhs) and news (rhs) signals

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

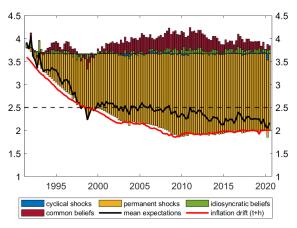


Figure: Historical decomposition of average inflation expectations

 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
- \Rightarrow 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

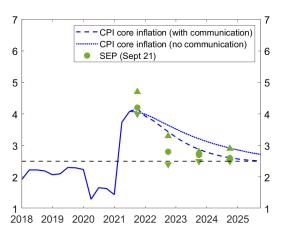


Figure: Inflation path consistent with re-anchoring average long-term inflation expectations at 2.5 percent from 2021Q4

► 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:

- 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!