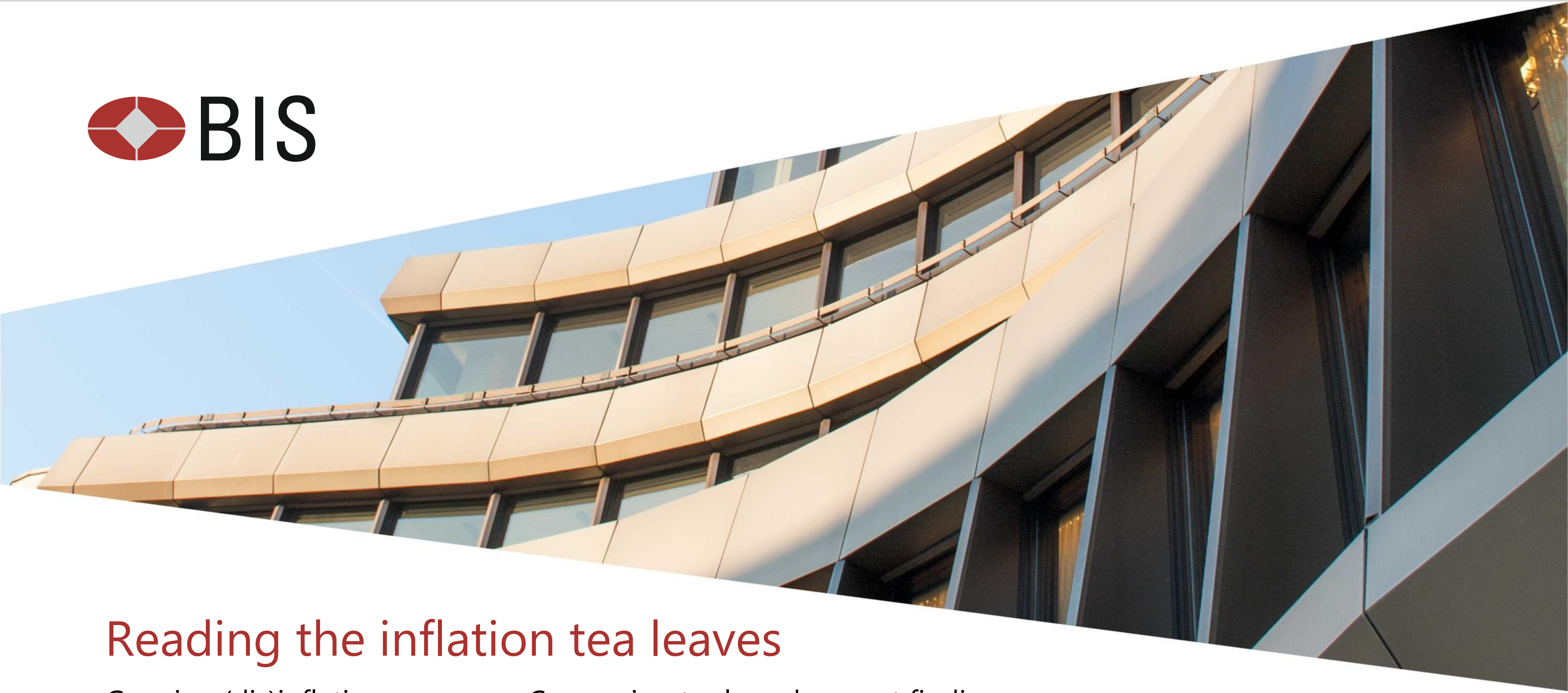


Reading the inflation tea leaves

Gauging (dis)inflation pressures: Comparing tools and current findings
SUERF-BIS webinar, 10 February 2023

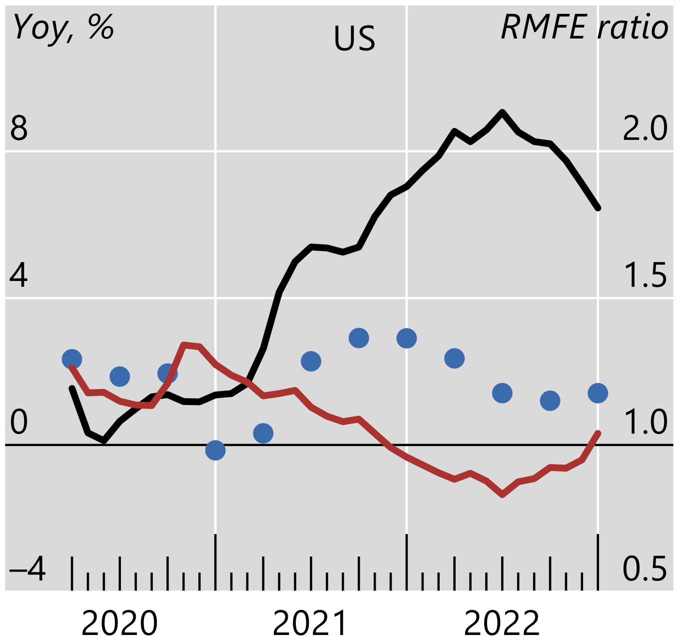
Deniz Igan

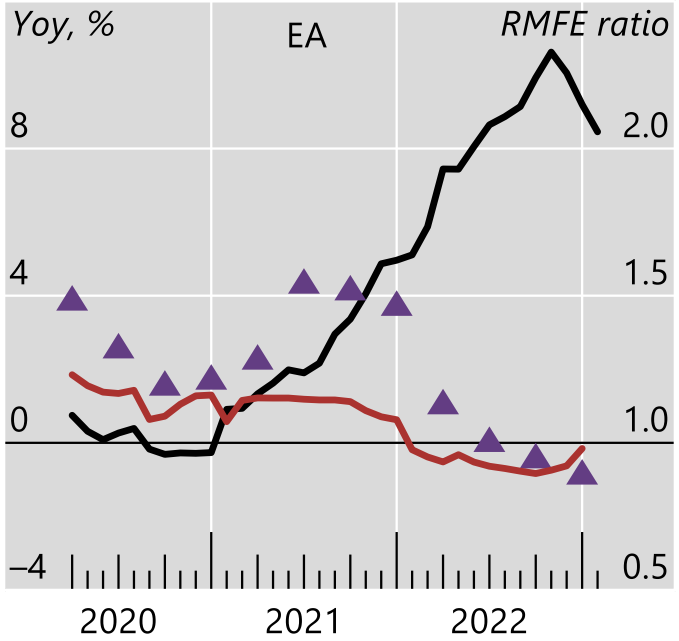
Views expressed are the presenter's and not necessarily those of the BIS.

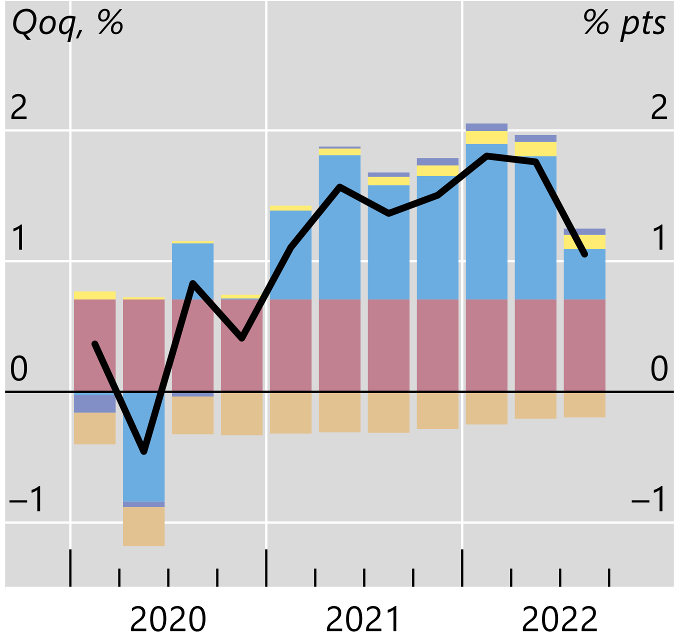
A taxonomy of inflation indicators

	Timeliness	Diagnosis ability	Prognosis ability	Adaptability
Headline, core, trimmed readings	High	None	Often hard-to-beat benchmarks	May reflect regime shift
Granular measures (similarity, spillovers)	Typically high	Suggestive	Unknown	May signal turning points
Expectations: market-based	Very high	None	Good but beware of risk premia	Full distribution may predict a shift
Expectations: survey-based	Typically low	Some, esp. when anchor is weak	Good but beware of biases	Full distribution may predict a shift
Models: time series	Very high	Limited	Typically good	May be unstable in regime shifts
Models: (semi-) structural	Low	High	Varies	Low

Performance of mean-reverting models deteriorates when inflation picks up, usefulness of full-fledged model insights hinges on correct specification







Lhs: Inflation

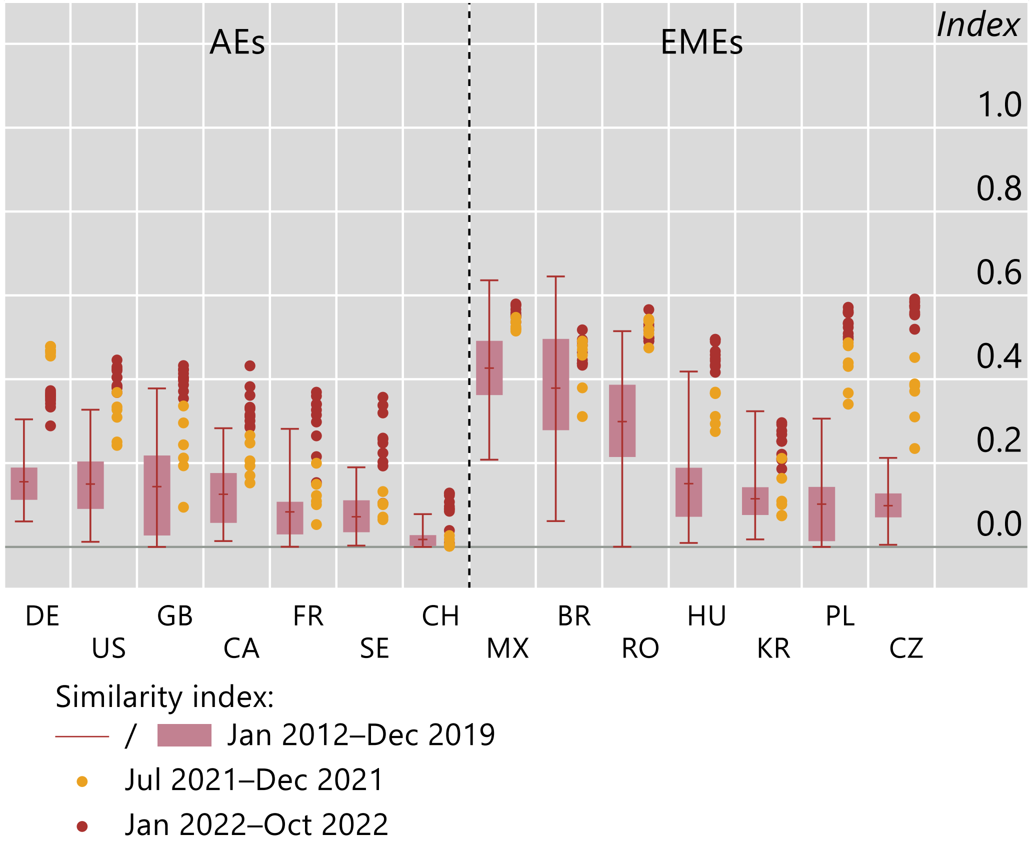
Rhs: Ratio of root mean forecast error (RMFE): RW vs DSGE; RW vs AR; RW vs official

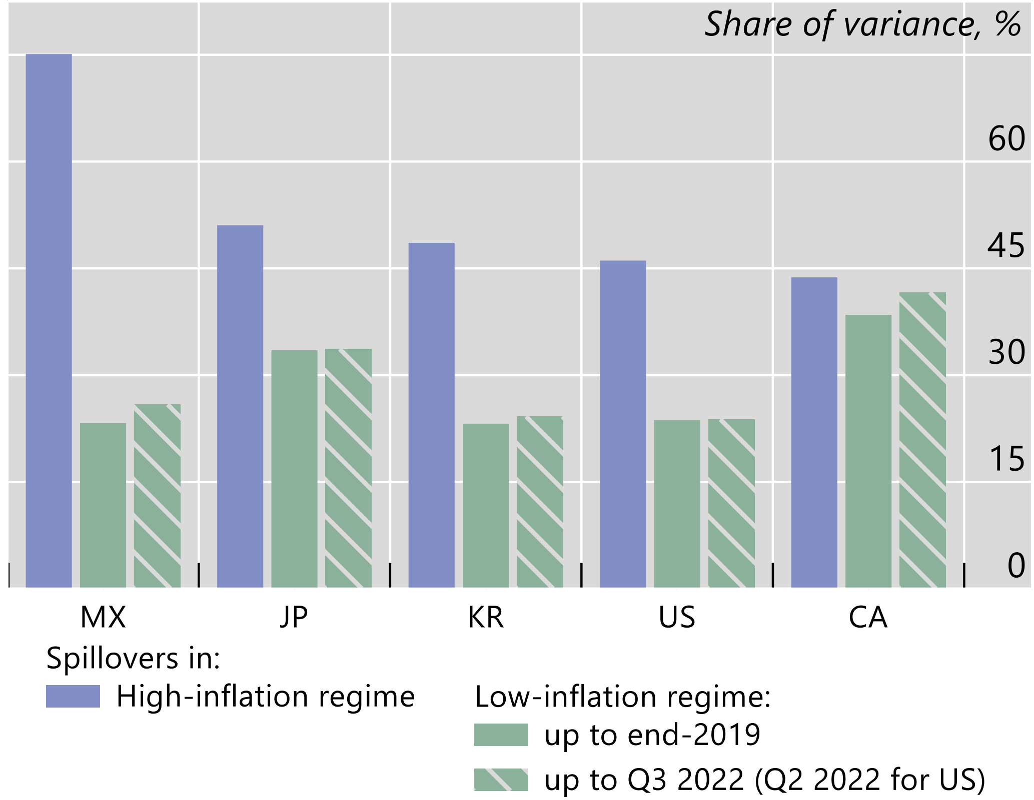
Lhs: Inflation

Rhs: Contributions: Constant; Cost push; Monetary policy; Wages; Other

Source: BIS Bulletin no 60.

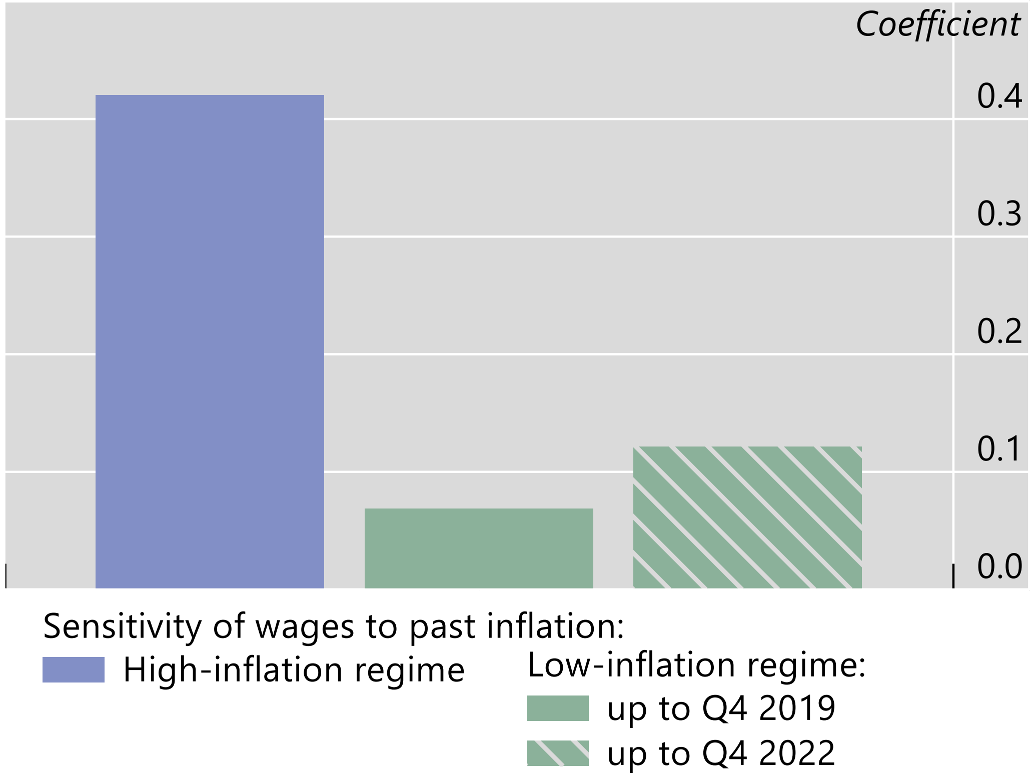
Current indicators give mixed signals on a transition to a high-inflation regime: Sectoral price changing becoming more similar and spillovers increasing…

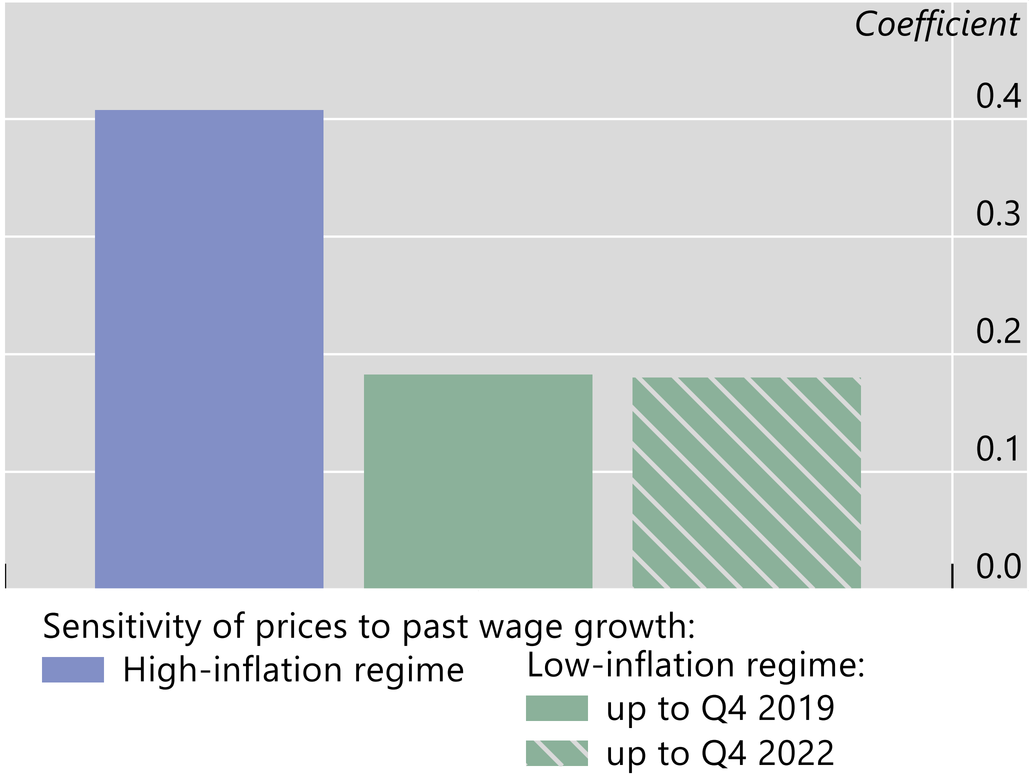




Source: BIS Bulletin no 60.

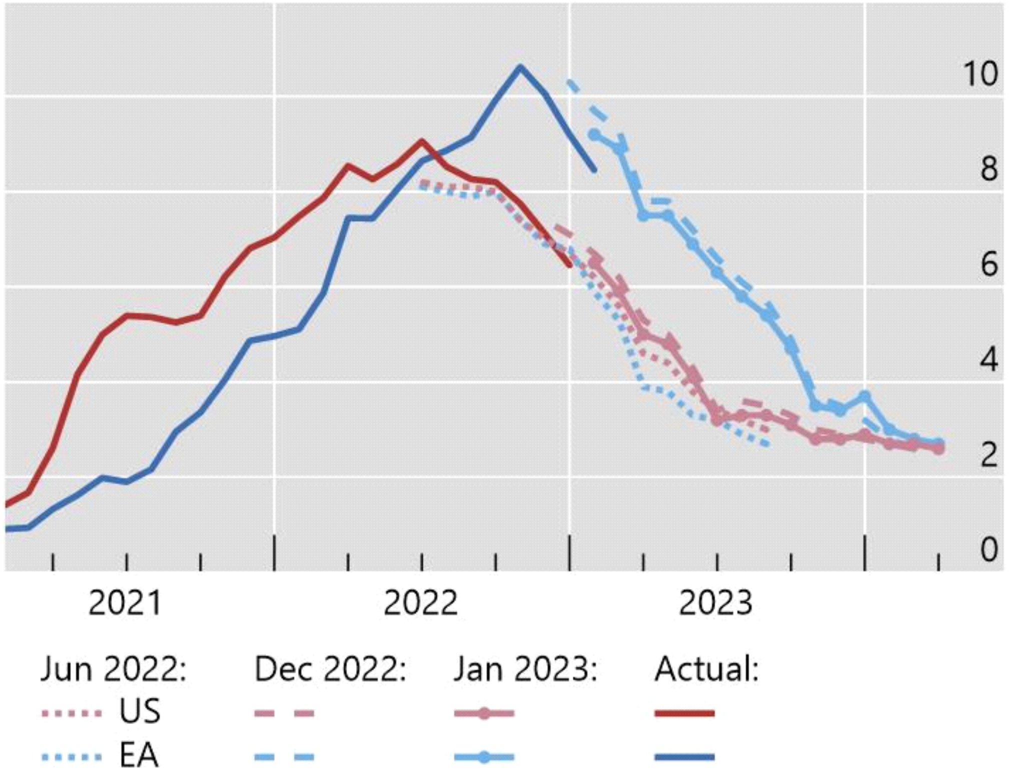
…at the same, sensitivity of wages to past inflation only mildly higher while that of prices to past wage growth is stable

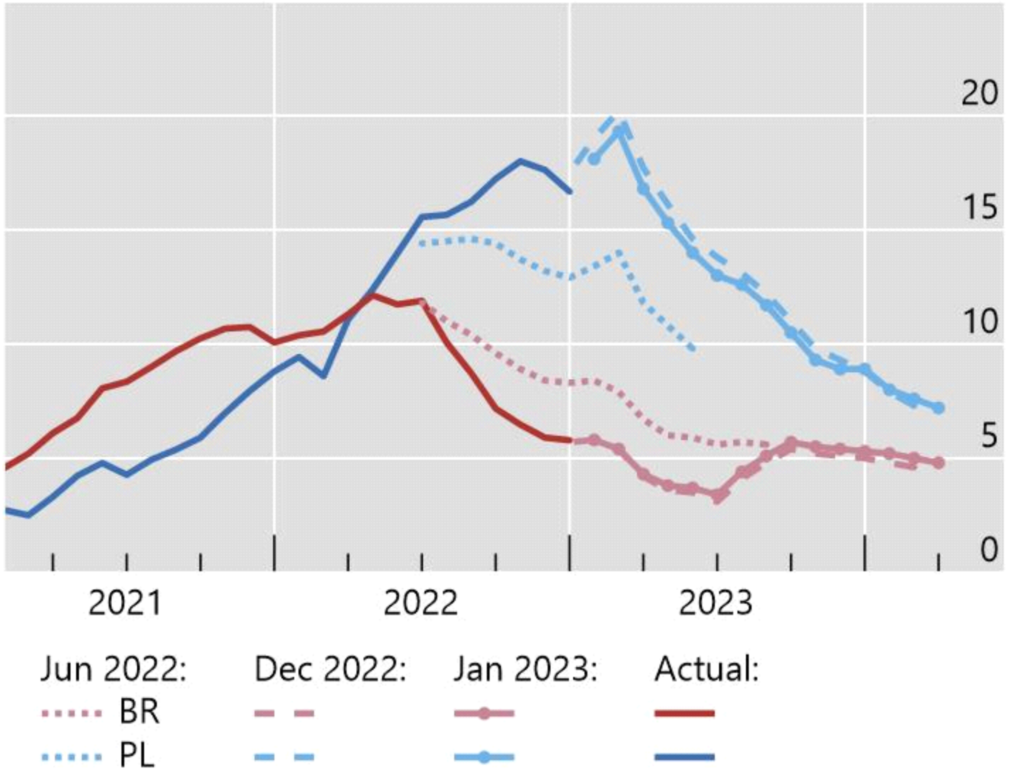




Source: BIS Bulletin no 60.

Evolution of forecast errors tells a story: expectations/models have finally caught up to actual readings but not at the same time for all countries





Source: Consensus Economics.

Key takeaways

- When inflation is low, sector-specific price changes explain most of it
  - Core a more accurate signal than headline
  - Little relation to price- and wage-setting decisions
- The opposite holds when inflation is high
  - Synchronicity across sectors become prominent
  - Price changes become more salient to firms and workers
- How useful different indicators are depend on the regime
  - Particularly unreliable during transitions
  - Signals of ongoing transition:
    - Drifting expectations,
    - Increase in sectoral co-movements and spillovers,
    - Rising pass-thru from wages to prices and vice versa

Based on work by numerous BIS colleagues, most notably, Fiorella De Fiore, Marco Lombardi, Dan Rees with support from Burcu Erik and Alexis Maurin

For more:

Inflation indicators amid high uncertainty

Inflation: a look under the hood