

Discussion of
Inflation Expectations - a Policy Tool
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Survey inflation expectations

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 - Disagreement about present and future.
 - Slow diffusion of information, past experiences linger.
 - Update in response to news, faster in volatile environment.
 - Available data (shopping, media) affects expectations.
 - Last 20 years, many unaware of what ECB does, its targets.

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 - Last 30 years, many unaware of what ECB does, its targets.
 - Not just limited information, lack credibility, backward looking

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 - Use distributions for uncertainty (never disagreement).
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 - Design of questions matters, ranges matter, priming.
 - Sampling on characteristics matters.
 - Expectations of individual versus aggregate variables matters.

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 - Sampling on characteristics matters.
 - Expectations of individual versus aggregate variables matters.
 - Require ECB involvement and effort, but worthwhile

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 - Higher expected spending, higher willingness to spend.
 - Sometimes, raise prices/wages.
 - Sometimes, lower hiring/investment.
 - **Are not just noise, can be very informative**

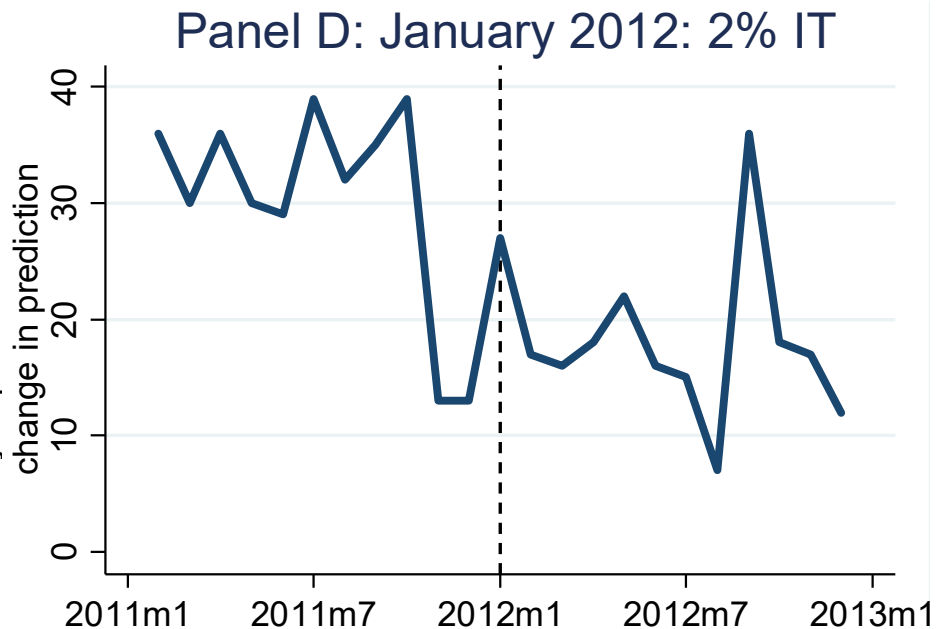
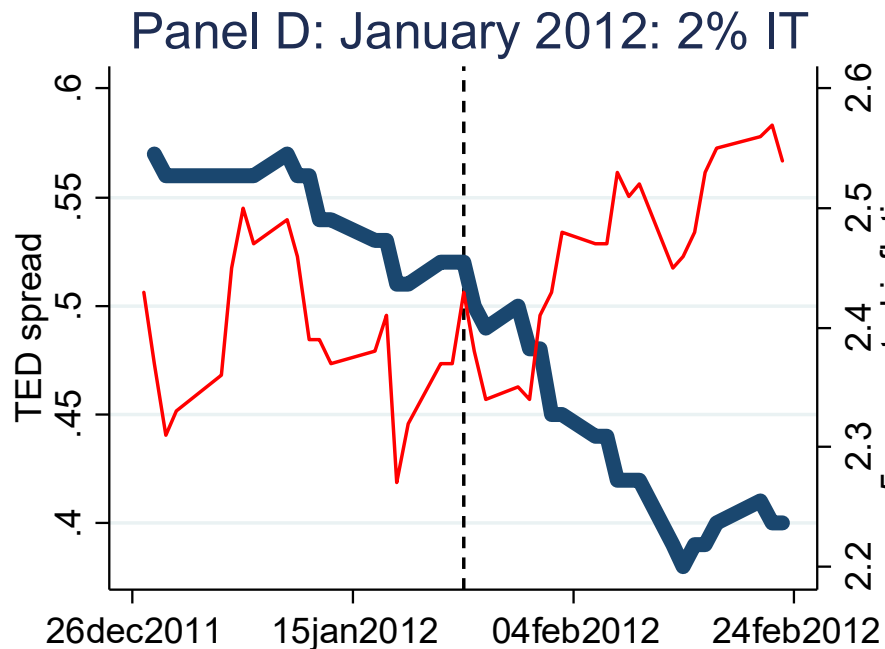
Survey inflation expectations

4. Policy announcements have little effect on them

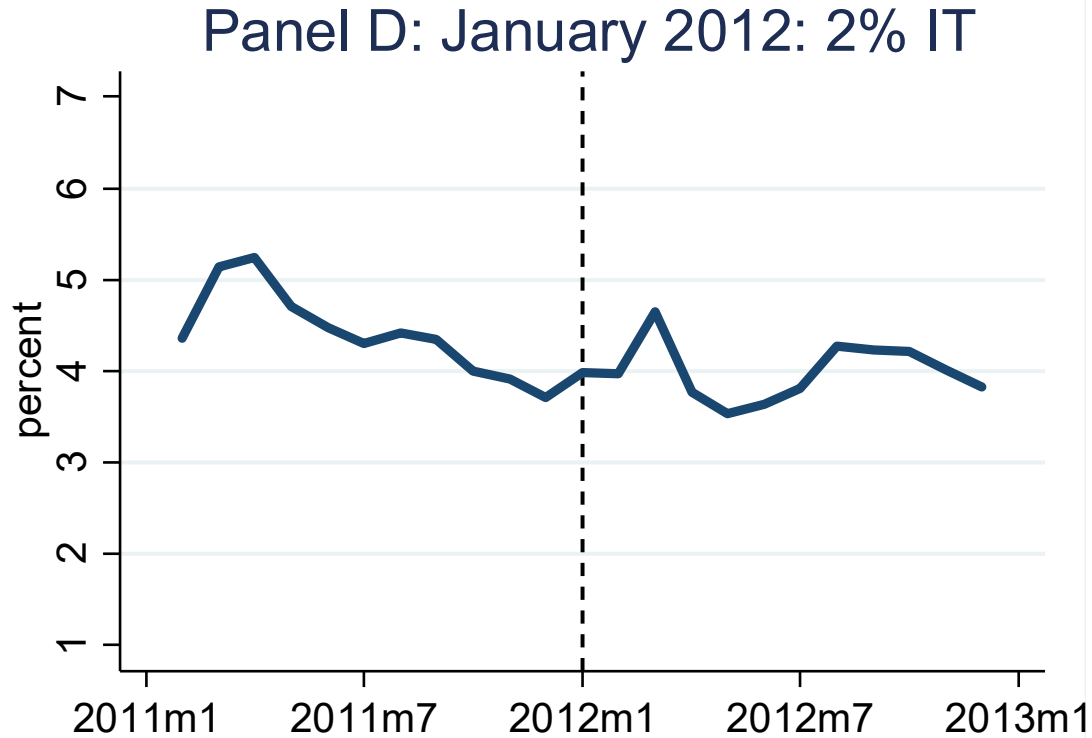
Survey inflation expectations

4. Policy announcements have little effect on them
 - Given inattention, at best only some people.
 - Given sticky information, lower frequency.
 - Given correlation speeches and actions, must disentangle.
 - Given reverse causality, hard to identify.

Authors' event study



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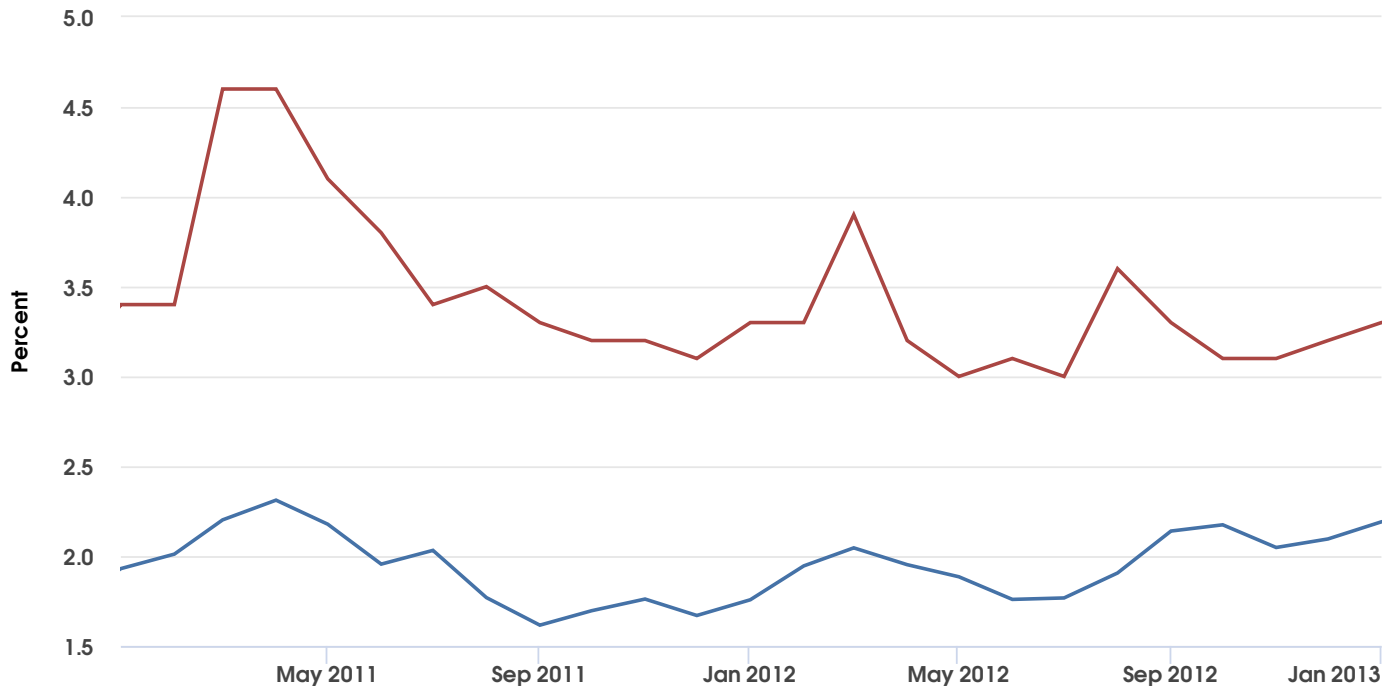


Same frequency

FRED



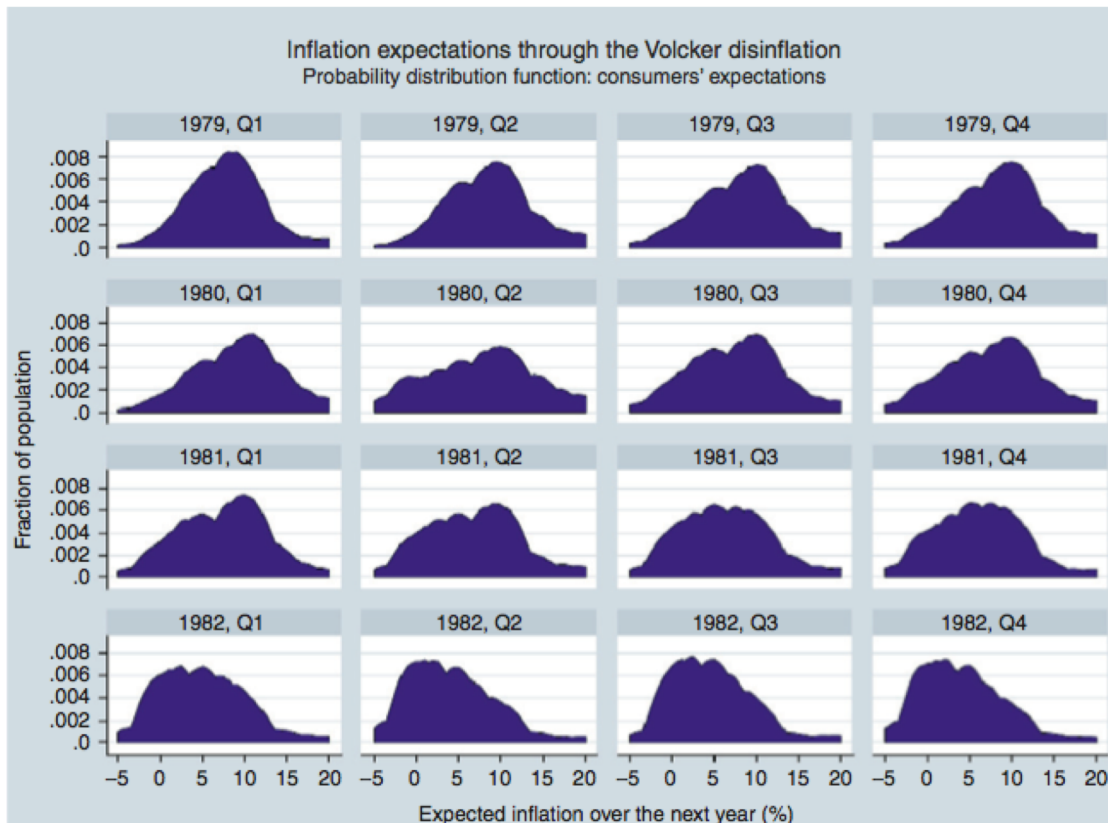
— 5-Year Breakeven Inflation Rate
— University of Michigan: Inflation Expectation



Survey inflation expectations

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 - Given reverse causality, hard to identify.
 - Very hard to know, maybe, I just don't know at high frequencies

Volcker disinflation



Source: Mankiw, Reis, Wolfers, 2004

Inflation targeting and professionals

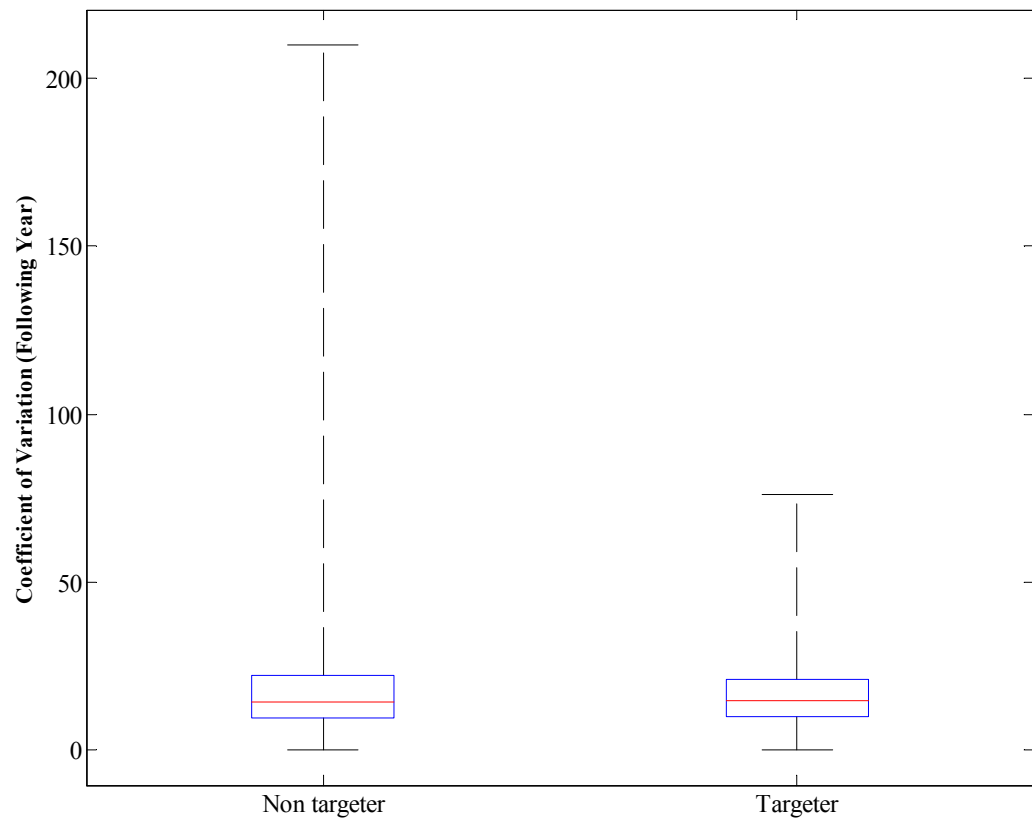


Figure 1. Box plots of Coefficients of Variation (1989:10 - 2006:11)^{2/}

Inflation targeting and professionals

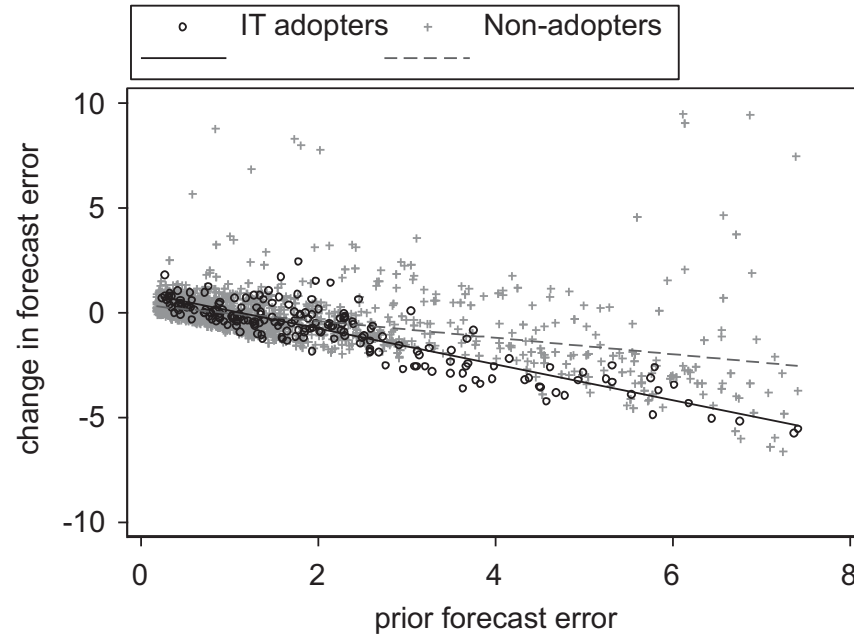


Fig. 1. Change in forecast performance around IT adoption. Change in average absolute forecast errors between the 12 months prior to IT adoption and the subsequent 12 months plotted against the average absolute forecast error in the 12 months prior to IT adoption. Sample includes 196 forecasters in IT adoption countries and 2,048 forecasters in non-IT adoption countries. Sample imposes a common support in terms of prior forecast error between the IT and non-IT adoption group. Sample is trimmed to exclude outliers (defined as an absolute change in the forecast error in excess of 10 percentage points).

Survey inflation expectations

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5. Better communication can break inattention
 - Revealing past or target inflation changes expectations. *Target message to scenario*
 - FOMC statements add little, news adds little. *Simple messages do better*
 - Information revealed affects expectations for at best 6 months. *Repeat the message*
 - *Take the message direct to the target evidence*

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 - Information revealed affects expectations for at best 6 months. *Repeat the message*
 - *Take the message direct to the target evidence*
 - **Sensible, but no evidence right now.**

Survey inflation expectations

1. Are consistent with widespread inattention **Yes**
2. Can be properly measured, with effort **Yes**
3. Are correlated with actual economic decisions **Yes**
4. Policy announcements have little effect on them **No**
5. Better communication can break inattention **?**

Are household or firms' survey inflation expectations a policy tool?

Tool and effect

- *Tool*: communication, speeches, c .
- *Effect*: survey expected inflation, π^e
- *Control*: independent of other policies p
- *Transmission*: from expected to actual inflation: π

- Question:

$$\frac{\partial \pi}{\partial c} = \frac{\partial \pi}{\partial \pi^e} \times \frac{\partial \pi^e}{\partial c} \Big|_p$$

The three hypotheses

$$\left. \frac{\partial \pi^e}{\partial c} \right|_p = f(p_+, \pi, c)$$

- A. Is communication revealing future policy?
- B. Is communication revealing fundamental information?
- C. Is communication moving expectations independently?

The three hypotheses

$$\left. \frac{\partial \pi^e}{\partial c} \right|_p = f(p_+, \pi, c)$$

- A. Is communication revealing future policy?
 - B. Is communication revealing fundamental information?
 - C. Is communication moving expectations independently?
- **Evidence** from forward guidance and policy dates, using financial markets, points to a lot of B, some A.
 - **Spirits?** Hyperinflation evidence, propaganda danger.

Two more issues

How far away? fine tuning and anchoring

$$\left. \frac{\partial \pi_{t+T}^e}{\partial c_t} \right|_p$$

Which inflation component? as $\pi_t = \pi_t^P + \pi_t^T$

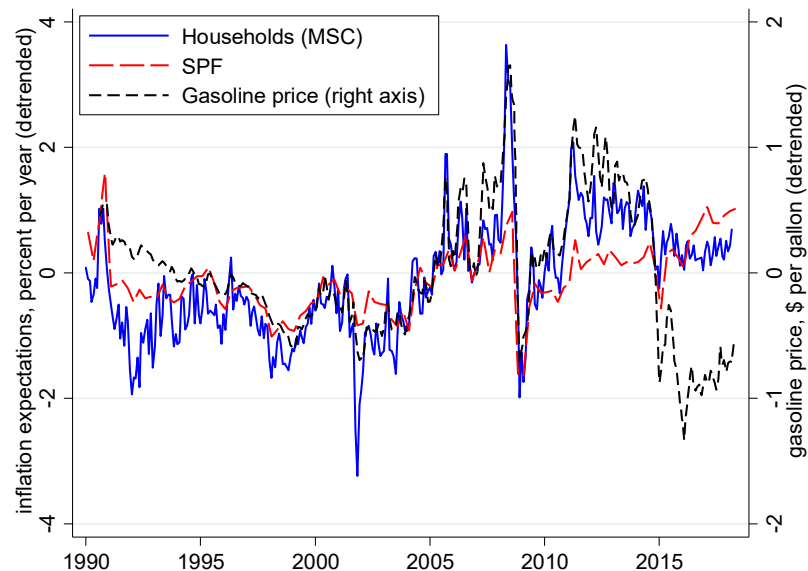
$$\left. \frac{\partial \pi_{t+T}^P}{\partial c_t} \right|_p$$

Working backwards: transitory

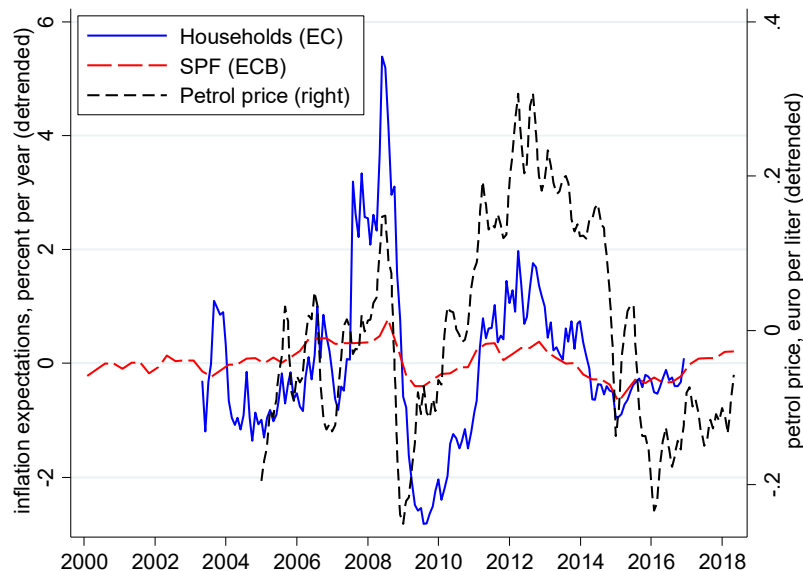
Figure 2

Household Inflation Expectations and Gasoline (Petrol) Prices

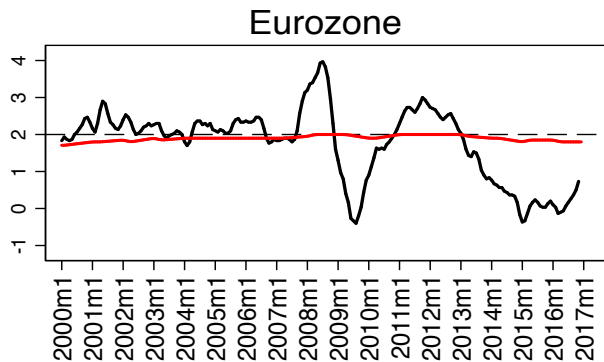
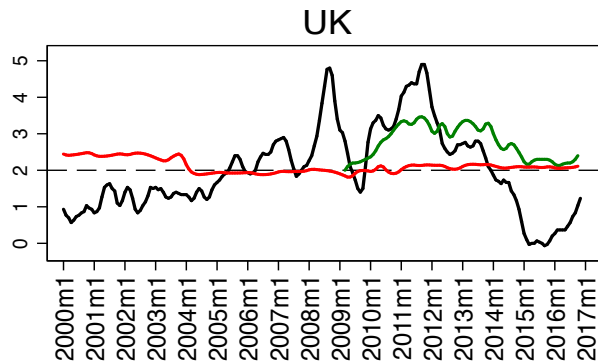
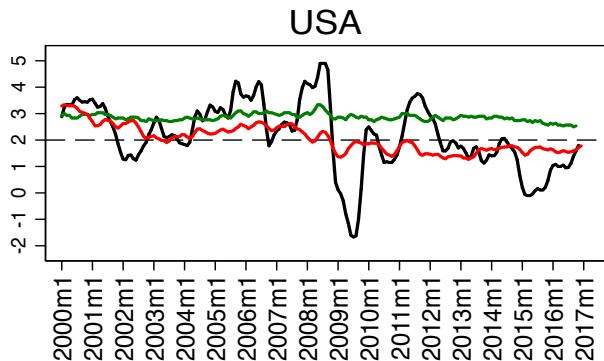
Panel A: United-States



Panel B: Euro Area

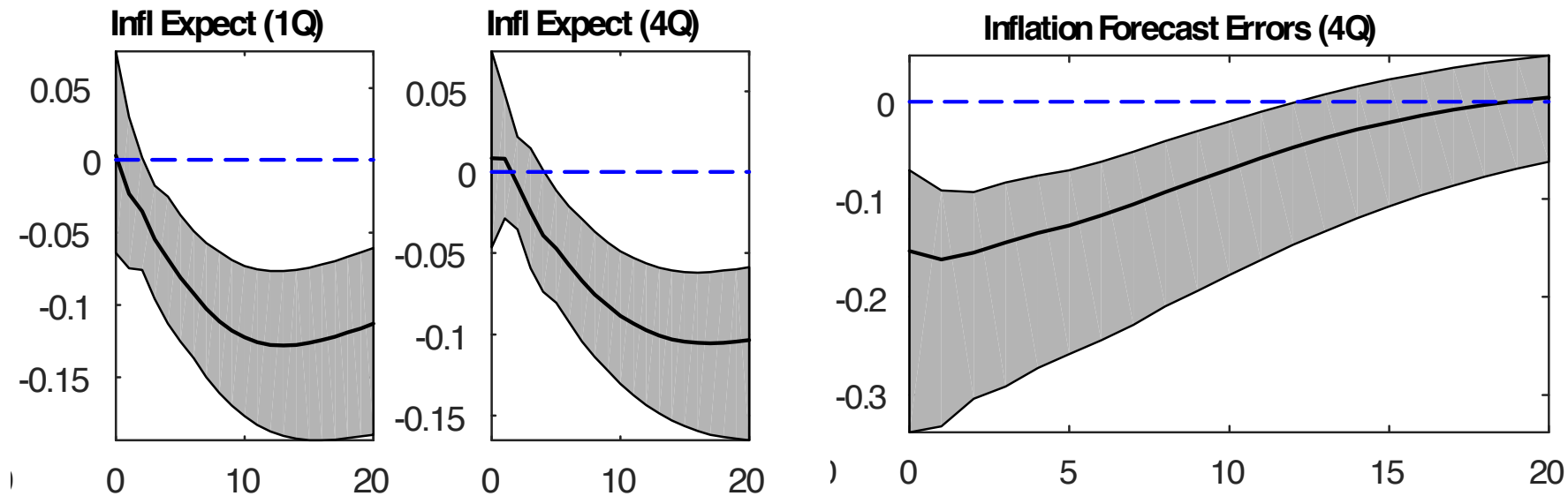


Anchoring: success of last 10 years



— Infl. — Cons.
— Prof.

Fine tuning: sticky information key



Inattention says go beyond average

Figure 2.14 Dispersion of Inflation expectations in the US

A: Consumers, 12 months

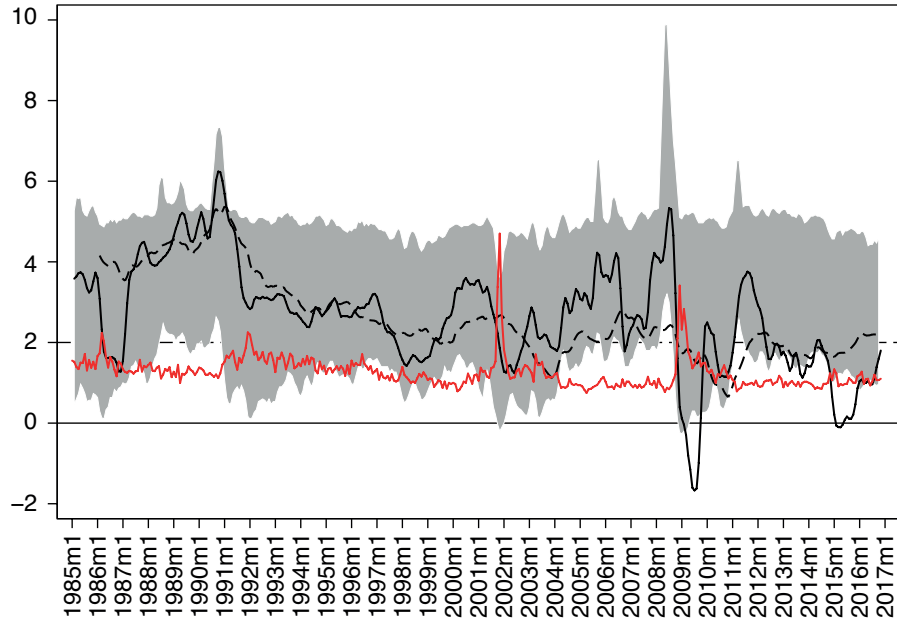
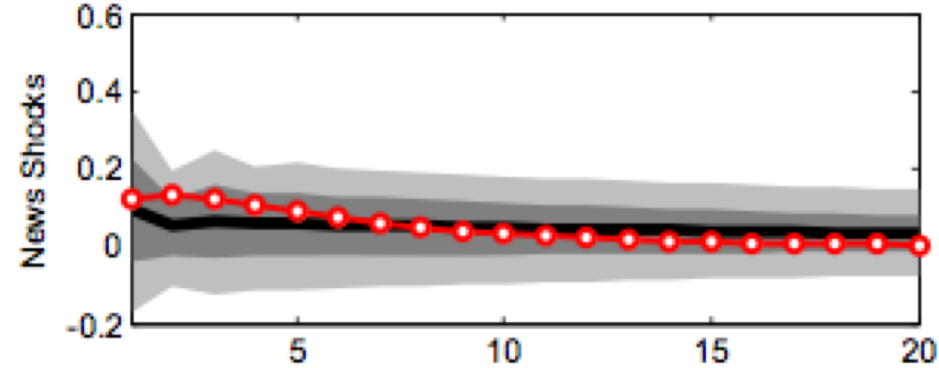


Figure 5. Response of Disagreement among Consumers,



My interpretation

1. Moving “animal spirits” is very hard, communicating fundamentals and policy is unavoidable,
2. Households/firms focus on transitory, must extract signal on permanent, so look at more moments.
3. Inattention makes anchoring easier but fine tuning harder. Compare with food labelling...

Monetary policy as a stable unit of account: success.

Monetary policy as stabilization policy: harder.

Conclusion

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- Must take survey inflation expectations seriously as data.
- Shift focus, resources, and policy attention to impact of measures on surveys of inflation.
- Effects of policy: limited knowledge, but duty to inform about fundamentals and policies, better design communication.
- More evidence of success as an anchor.