THE INFLATION EXPECTATIONS OF U.S. FIRMS:
EVIDENCE FROM A NEW SURVEY

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WHY EXPECTATIONS?

Key variable for economic decisions: perceived real interest rate

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Mario Draghi (2015): “*When inflation expectations go up with zero nominal rates, real rates go down. When real rates go down, investments and the economic activity improves. That’s the reasoning [of QE].*”
Inflation expectations is a key object for central banks:
• Alan Greenspan, “I am not saying what [inflation expectations] is a function of. We know it’s a very difficult issue, but that is the key variable. It’s important, but just because we can’t make a judgment as to what these driving forces are in an econometric sense doesn’t mean that it’s not real.”
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- Ben Bernanke (2007): “How should we measure inflation expectations, and how should we use that information for forecasting and controlling inflation? I certainly do not have complete answers to those questions, but I believe that they are of great practical importance. … Information on the price expectations of businesses--who are, after all, the price setters in the first instance--…. is particularly scarce.”
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INFLATION EXPECTATIONS: STATE OF KNOWLEDGE

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Survey of Firms’ Inflation Expectations (SOFIE)

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- A large sample (200-400 firms) with a panel component
- Coverage
  - Manufacturing (55% of the sample)
  - Services (45% of the sample)
- Size distribution
  - Small (1-19 employees; 45% of the sample)
  - Medium (20-249 employees; 35% of the sample)
  - Large (250+; 20% of the sample)
Q1: “What do you think will be the inflation rate (for the Consumer Price Index) over the next 12 months? Please provide an answer in an annual percentage rate.”

Note:

- Respondents are asked to provide a point estimate → minimize priming effects
- We ask about the inflation rate rather than the general level of prices.
- We refer to a specific price index (CPI) to avoid any confusion about which inflation rate respondents should refer to in their forecasts.
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Q2A (April wave). “What annual inflation rate do you think the U.S. Federal Reserve is trying to achieve on average?”

Test knowledge about the central bank’s objectives
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Measure perceptions of inflation
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Q2C (October wave). “What do you think will be the average inflation rate (for the Consumer Price Index) over the next 5 years? Please provide an average annual percentage rate.”

Measure long-term inflation expectations (how anchored expectations are)
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Q2C (October wave). “What do you think will be the average inflation rate (for the Consumer Price Index) over the next 5 years? Please provide an answer in an average annual percentage rate.”

Q2D (January wave). “What do you think is the probability that the annual inflation rate (for the Consumer Price Index) over the next 12 months will exceed 5%?”

Measure uncertainty about future inflation
Panel B: Disagreement (standard deviation)
Survey date: 2019Q1
$b = 0.71 \ (0.06)$

$R^2 = 0.62$
ARE EXPECTATIONS ANCHORED?

Five predictions:

- Inflation expectations are close to the target.
- There is little disagreement in expectations.
- Revisions in inflation expectations are small.
- Firms show confidence in their forecasts.
- Short- and long-term inflation expectations are uncorrelated.
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Five predictions:

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CONCLUDING REMARKS

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- Need good measurement (especially for firms) ⇒ SoFIE
- Expectations are far from full-information rational expectations (FIRE)
- Expectations don’t seem to be particularly anchored (sign of success?)
CONCLUDING REMARKS

- Management of expectations is potentially a very powerful tool
- Need good measurement (especially for firms) \(\Rightarrow\) SoFIE
- Expectations are far from full-information rational expectations (FIRE)
- Expectations don’t seem to be particularly anchored (sign of success?)
- Invest resources to have infrastructure for measurement and communication
- Build frameworks that explicitly model information rigidities