Inflation expectations and the conduct of monetary policy

Frankfurt am Main,
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Shifts in risk premia driving decline in long-term inflation expectations

**Decomposition of 5y5y ILS rate**
(cumulative change since 1-Jan-2014; percentage points)

![Graph showing decomposition of 5y5y ILS rate]

Sources: Thomson Reuters and ECB calculations.
Notes: The 5y5y rate and its components are re-based to zero at the beginning of January 2014. The decomposition is derived on the basis of an affine term structure model fitted to the euro area zero-coupon inflation linked swap curve.
Latest observation: June 2019.

**Decomposition of 1y2y ILS rate**
(cumulative change since 1-Jan-2014; percentage points)

![Graph showing decomposition of 1y2y ILS rate]

Sources: Thomson Reuters and ECB calculations.
Notes: The 1y2y rate and its components are re-based to zero at the beginning of January 2014. The decomposition is derived on the basis of an affine term structure model fitted to the euro area zero-coupon inflation linked swap curve.
Latest observation: June 2019.
Households likely to use simple heuristics in forming expectations

Household inflation expectations and HICP inflation
(left-hand scale: balance statistic; right-hand scale: percent per annum)

Sources: European Commission and ECB.
Notes: Inflation expectations refer to expectations for the next 12 months.
Latest observation: June 2019.
Frequently purchased goods may affect household inflation expectations.

**Inflation and inflation expectations**

(left-hand scale: balance statistic; right-hand scale: percent per annum)

Sources: European Commission and ECB.
Notes: Inflation expectations refer to expectations for the next 12 months.
Latest observation: June 2019.
Near-term inflation expectations similar for households and professional forecasters

Inflation expectations by consumers, professional forecasters and financial markets
(left-hand scale: balance statistic; right-hand scale: percent per annum)

Sources: European Commission, Consensus Economics, Reuters and ECB.
Notes: Inflation expectations refer to expectations for the next 12 months. For the period 1990 to the second quarter of 2002, Consensus Economics data refer to the average of expectations for Germany, France and Italy. Data for inflation swap rates are only available since early 2005.
Latest observation: June 2019.
Predicting inflation is often a challenging process, both for central banks…

HICP inflation: realised and Eurosystem projections
(% per annum)

Sources: ECB and Eurostat.
HICP inflation: realised and ILS-implied expectations
(% per annum)

Sources: Reuters and ECB calculations.
Notes: Historical ILS-implied inflation expectations are 1-year ILS forward rates over different horizons, calculated from spot ILS rates.
Latest observation: June 2019.
Changes in inflation expectations can affect financial conditions

Decomposition of 10-year euro area overnight index swap rate
(cumulative change since 1-Jan-2018; percentage points)

Source: Thomson Reuters and ECB calculations.
Note: The real rate is calculated by subtracting the inflation-linked swap rate from the nominal OIS rate.
Inflation expectations affect consumption decisions

Inflation expectations and readiness to spend
(vertical axis: see notes; horizontal axis: percentage points)


Notes: Readiness to spend is a qualitative variable ranging from 1 (the consumer is not ready to spend) to 3 (the consumer is ready to spend). Each “dot” in the figure represents a country average of the readiness to spend indicator and a country average of the expected change in inflation for a given month. The red solid line shows the linear relationship between the two indicators estimated by ordinary least squared regression.

Latest observation: December 2016.
Consumer inflation expectations help predict future wage growth

Compensation per employee: realised and forecasts
(y-on-y percent change)

Source: ECB calculations.

Notes: Regression specification: \( \% \Delta \text{compensation}_t = \beta_0 \text{X}_{t-1} + \beta_1 \text{unemployment}_t + \beta_2 \% \Delta \text{productivity}_t + \epsilon_t \), where \( \text{compensation} \) is compensation per employee, \( \text{X} \) is the variable specified in the legend, \( \text{unemployment} \) is the unemployment rate, \( \text{productivity} \) is GDP per employee, and \( \epsilon_t \) is the error term. The estimation sample is 2003 to 2017. Latest observation: 2019Q1.

![Graph showing realized compensation and various forecasts](image-url)
Household inflation perceptions and expectations
(balance statistic)

- "deanchoring" measure
- Current inflation perceptions

Introduction
Source: European Commission and ECB.
Notes: The “deanchoring” measure is calculated as the (unweighted) sum of the responses “increase more rapidly” or “fall”. For inflation perceptions, the measure combines the responses “risen a lot” and “fallen.”
Latest observation: June 2019.

Household inflation perceptions and expectations
(lhs: balance statistic; rhs: percent per annum)

- "deanchoring" measure
- HICP energy and unprocessed food (right-hand axis)

Source: European Commission and ECB.
Notes: The “deanchoring” measure is calculated as the (unweighted) sum of the responses “increase more rapidly” or “fall.”
Latest observation: June 2019.
Thank you for your attention