Yellen, Janet L. 2016. "Macroeconomic Research after the Crisis." Speech at The Elusive "Great" Recovery: Causes and Implications for Future Business Cycle Dynamics, 60th Annual Economic Conference sponsored by the Federal Reserve Bank of Boston, Boston, Massachusetts, October 14. https://www.federalreserve.gov/newsevents/speech/yellen20161014a.htm.

GENERAL DISCUSSION Robert Hall commented that extending the analysis from a concern of expectations—the first moment of the conditional distribution of future inflation—to the entire distribution is a big step forward. Hall also notes that Ricardo Reis does not say anything about current inflation. Reis noted that monetary policy response to changes in expectations may make inflation persistently higher, and he was exploring whether the whole distribution is a leading indicator for changes in the inflation regime.

Olivier Blanchard noted that the emphasis on expected inflation may be excessive in the current context. A central issue is whether workers who have seen prices increase and their purchasing power eroded will want to catch up and ask for higher wages. This is quite independent of their expectations about future inflation. If they do get increases in nominal wages, which are easier to get in a tight labor market, this might start a wage price spiral, give more momentum to inflation, and make it harder to decrease later.

Laurence Meyer considered what happened in 1968–1974 and suggested that this tells us nothing about what's relevant today; rather, it's an example of bad theory and bad policy, to which Reis responded that his point in the paper is that the bad policies were partly a result of ignoring inflation expectations data, missing their drift during that time. While this may or may not be where we are currently, it is a valuable lesson still today.

Meyer wondered why Reis does not mention the Index of Common Inflation Expectations (CIE), a weighted average of market-based and survey measures, which is a better measure of inflation expectations.[1] Meyer argued that, in contrast to what Reis suggests, the data show that inflation expectations are remarkably stable, as one would expect, and that we should not pay this kind of attention to quasi-supply shocks, although he agreed that there are many possible outcomes for inflation going forward and that supply shocks make inflation expectations difficult to predict.

1. See Hie Joo Ahn and Chad Fulton, "Index of Common Inflation Expectations," FEDS Notes, September 2, 2020 (Washington: Board of Governors of the Federal Reserve System), https://www.federalreserve.gov/econres/notes/feds-notes/index-of-common-inflation-expectations-20200902.htm.

Jason Furman then pondered about how the work of Reis compares to the Federal Reserve's CIE, which, he said, does not have any logic in how it relates to inflation expectations but only an internal logic of a set of correlates and, he suggested, is very inertial in its construction as an AR(4), with a slow effect of inflation expectations on the index. Furman wondered about where there's a structural break in these measures.

In response, Reis said that he finds the CIE to be a flawed measure, extracting a common component from a factor model that mixes indicators of fundamentally different variables: it has expectations from different people, markets, moments, and maturities, while ignoring the economics that tightly links them. Moreover, the factor model uses a sample of data to estimate correlations between these variables that likely changed dramatically in the last year, ultimately making it uninformative, Reis concluded.

Gerald Cohen recalled the substantial decline in inflation expectations in the mid-2010s, which did not see inflation decline, and asked whether Reis thinks that there is an asymmetry in the impact of inflation expectations or if this episode was just an outlier. Reis responded by referring to his paper where he finds a drift down in inflation expectations between 2012 and 2018 of 20 basis points—and even more in the eurozone. Significant and interesting, but much smaller than the drift up in the late 1960s (or today).[2]

Robert Gordon pointed out that the oil shock and the end of price control in the 1970s were both permanent in contrast to the current price increases, which will likely come down and add a negative component to inflation. The wide wage indexation during the 1970s, which translated into wage behavior and back into inflation in a vicious circle, is not an issue today, he continued, noting that the labor shortages and rising wages for low-skill workers that we see currently will likely only have level effects.

Reis agreed with Gordon but pointed out that he does not consider the period after the oil shocks in his paper. His claim is that the drift in expectations happened before, after 1967, and this earlier unanchoring is part of the reason why the oil shocks then had such a persistent and large effect on inflation. Reis admitted that we are still pretty far, though, from making accurate short-term inflation predictions using only inflation expectations data. Connecting Gordon's comment on price controls to the presentations of Yuriy Gorodnichenko and Alan Blinder, Reis said that he hopes future research will explore the disproportionate impact that price controls seem to have on inflation expectations.

2. Ricardo Reis, "The People versus the Markets: A Parsimonious Model of Inflation Expectations," discussion paper 15624 (London: Centre for Economic Policy Research, 2021).

Going forward, Frederic Mishkin worried about a policy mistake like that seen in the 1970s in light of the Federal Reserve's new average inflation targeting framework which, he argued, requires a level of transparency about the horizon of this average that the Federal Reserve has not provided—which risks not anchoring inflation expectations at all.[3] Consequences for demand are particularly important, he claimed, and he pondered how temporary the current inflation surge is. He summed up by saying that this is a critical juncture and that future policy needs to be laid out very carefully to not exacerbate inflation expectations and inflation, resulting in substantial tightening as the Federal Reserve responds.

To Mishkin's point about policy mistakes, Reis remarked that there is one error that he hopes the Federal Reserve won't make, and that his paper will modestly help: not looking at the expectations data properly.

3. Enrique Martínez-Garcia, Jarod Coulter, and Valerie Grossman, "Fed's New Inflation Targeting Policy Seeks to Maintain Well-Anchored Expectations," Federal Reserve Bank of Dallas, April 6, 2021, https://www.dallasfed.org/research/economics/2021/0406.