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Speech in the presence of Jens Weidmann

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« Household Expectations »

Ladies and Gentlemen,

It is a great pleasure for me to open - with my colleague Jens Weidmann - this joint Bundesbank - Banque de France conference on households' expectations. I would like to thank warmly the Bundesbank: this French-German cooperation testifies that our two institutions can promote and contribute to good research on a very topical policy issue. Over the past year, the decline of market inflation expectations has been pronounced while households' expectations have been increasing quite steadily. This divergence is a challenge for our assessment on inflation expectations. All the interesting papers presented in the next couple of days will illustrate how much we can learn on inflation expectations when observing them outside financial markets.

I. Inflation expectations: a key issue for monetary policy

I.1. Policy relevance for Central Banks

Stable inflation expectations at a level close to our target are - of course - key for our monetary policy: they provide a strong nominal anchor helping us to stabilize inflation when facing large demand or supply shocks. Since the 1990s, management of inflation expectations through central bank communication has become a standard tool for monetary policy. A lot of evidence suggests that this policy has contributed to anchor inflation expectations and to reduce their volatility, while facing strong inflationary or deflationary shocks. The Great Financial Crisis is a good example: at that time, solid and well-anchored inflation expectations in the euro area contributed to counteract the strong deflationary forces affecting our economies.

However, since then, market-based measures of inflation expectations in the euro area have been decreasing and this decline has been even more pronounced since the beginning of 2019. This fall in market expectations has raised some questions among central bank watchers on potential risks of de-anchoring of inflation expectations and more generally on our ability to deliver our mandate of price stability.

I.2. The need for better information on households expectations

Let me stress that market-based inflation expectations are not the only available measures to assess future risks of inflation. Professional forecasters or consensus forecast provide a significantly higher figure than the 5Y/5Y ILS, at around 1,7% rather than 1,2% to 1,3%, although all of them point out to a decrease of inflation expectations over time (Figure 1). Market-based measures have also some technical limitations: first, related to the liquidity of financial markets, and second because they are affected by the evolution of the risk premium over time. Moreover, while financial market expectations provide information on future financing conditions, the evolution of prices and wages depends more deeply and directly on what household and firms expect regarding future growth and inflation. Consequently, existing surveys among firms and households can provide very useful and valuable information on expectations.

Better monitoring the general public's inflation expectations is not an easy task since inflation expectations of firms or consumers are not directly observable. For the moment, reliable data on consumers or firms' inflation expectations are quite scarce in the euro area whereas in other jurisdictions expectation surveys have been developed quite extensively – famous and recent examples include the New York Fed Survey, the Tankan survey in Japan or the different surveys developed by the Bank of England. In this respect, the new Bundesbank household survey contributes to fill the gap and it is also an excellent example of the recent efforts made by central banks to collect new and better information on expectations of economic agents.

II. Communication of central banks should also target households

For the moment, our most reliable information on the general public's inflation expectations in the euro area comes from the consumer survey conducted by the European Commission. When comparing the different sources of inflation expectations with consumer survey expectations, we can see that they deliver a very different message on the level of inflation expectations, compared to financial markets. European households perceive an inflation rate close to 10% whereas their inflation expectations are closer to 5%.

One implication of such a result is that we need to improve a lot our communication to a more general audience. Another conclusion we can draw is that, if households are not well aware of the level of inflation, they perceive quite well the overall evolution of inflation over time (Figure 2). As already pointed out by Benoît Coeuré[1], while households are not professional forecasters, their inflation expectations usually correlate very well with the ones anticipated by professional forecasters for the same forecast horizon (one year) (Figure 3). However, we can see over the recent period, a divergence between consumer expectations and financial markets indicators.

[1] B. Coeuré (2019). Inflation expectations and the conduct of monetary policy, Speech at an event organised by the SAFE Policy center, 11 july 2019

Since it could strongly affect the future path of inflation, such a pattern raises several important questions: will this divergence persist over time or is it very temporary? What are the sources of the divergence in inflation expectations between financial markets and households?

III. Firms' inflation expectations are also of primary interest for Central Banks

While this conference is mostly about households' expectations, I would like to stress that monitoring firms' inflation expectation is also of primary interest from a monetary policy perspective.

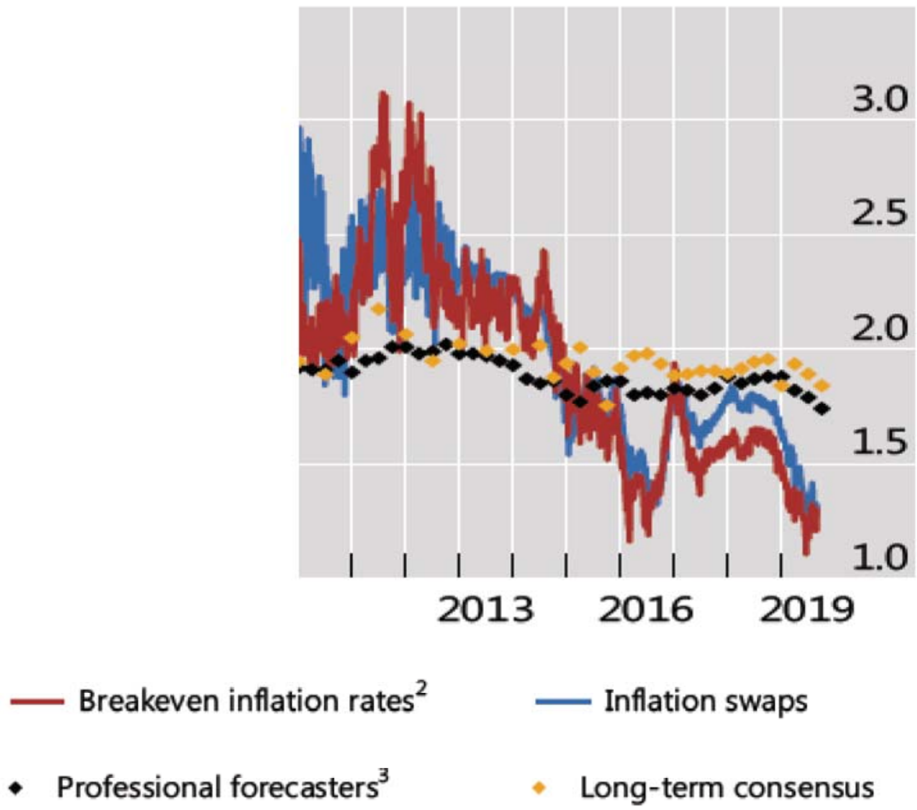
Compared to households, information on inflation expectations within firms is even scarcer. This scarcity of information is in sharp contrast with the relevance of such information for the conduct of monetary policy: at the end, firms are the price setters in the economy and also take part in the wage setting process. Besides, there is evidence that their expectations affect their economic decisions like employment or investment. One of the most comprehensive evidence has been produced for New Zealand's firms, showing that inflation expectations among business leaders are not so different from household expectations. In Europe, Banca d'Italia has also developed a very rich and informative firms' expectations survey since 1999. The Bundesbank has also conducted a very interesting survey asking trade-unions and employers what was the relevant inflation underlying the last collective wage agreement. Comparative information on such issues across the Euro area would be very useful. I am convinced that more analysis on firms' expectations would produce very valuable and relevant information for our monetary policy.

Conclusion

Let me now conclude by saying that we need to better measure consumer and firm inflation expectations. This lack of information prevents our communication policies from being fully efficient. One important question for monetary policy is what kind of communication tools can be used to better communicate with the general public and influence their inflation expectations.

This conference is a unique opportunity to benefit from the analyses of the most distinguished experts on the various exciting issues that are related to household expectations. I wish you very fruitful discussions. Thank you for your attention.

Figure 1. Long term inflation expectations for the Euro area



Source: BIS report “Recent developments in the global economy” (August 2019)

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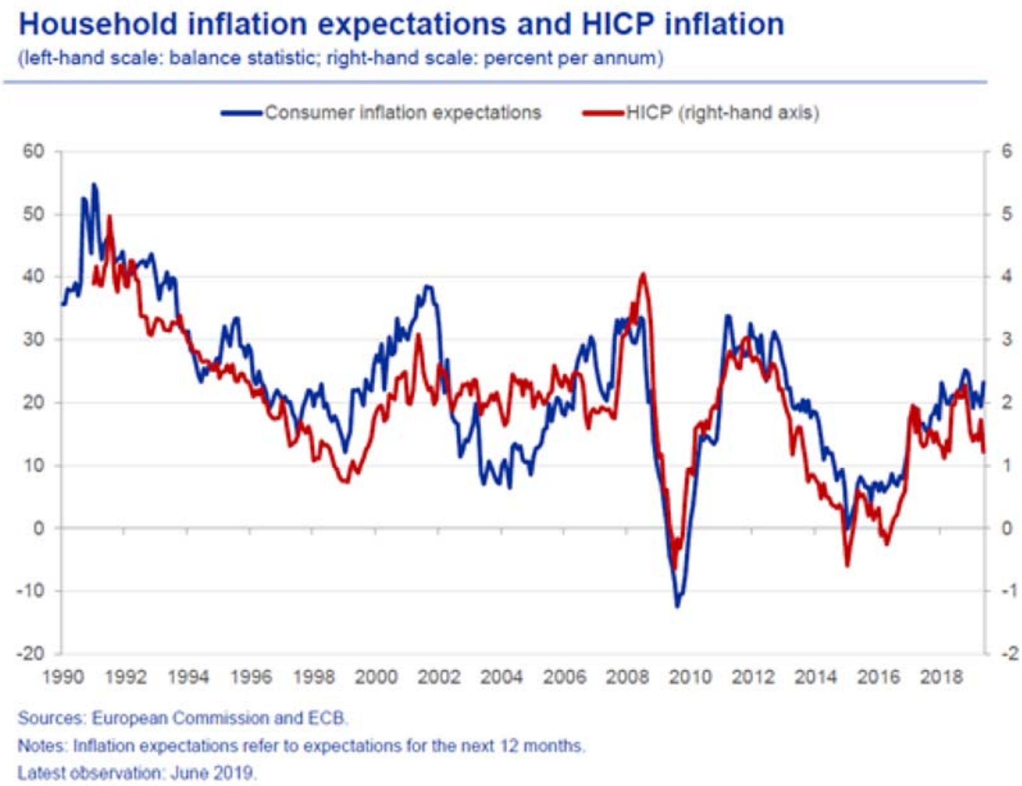
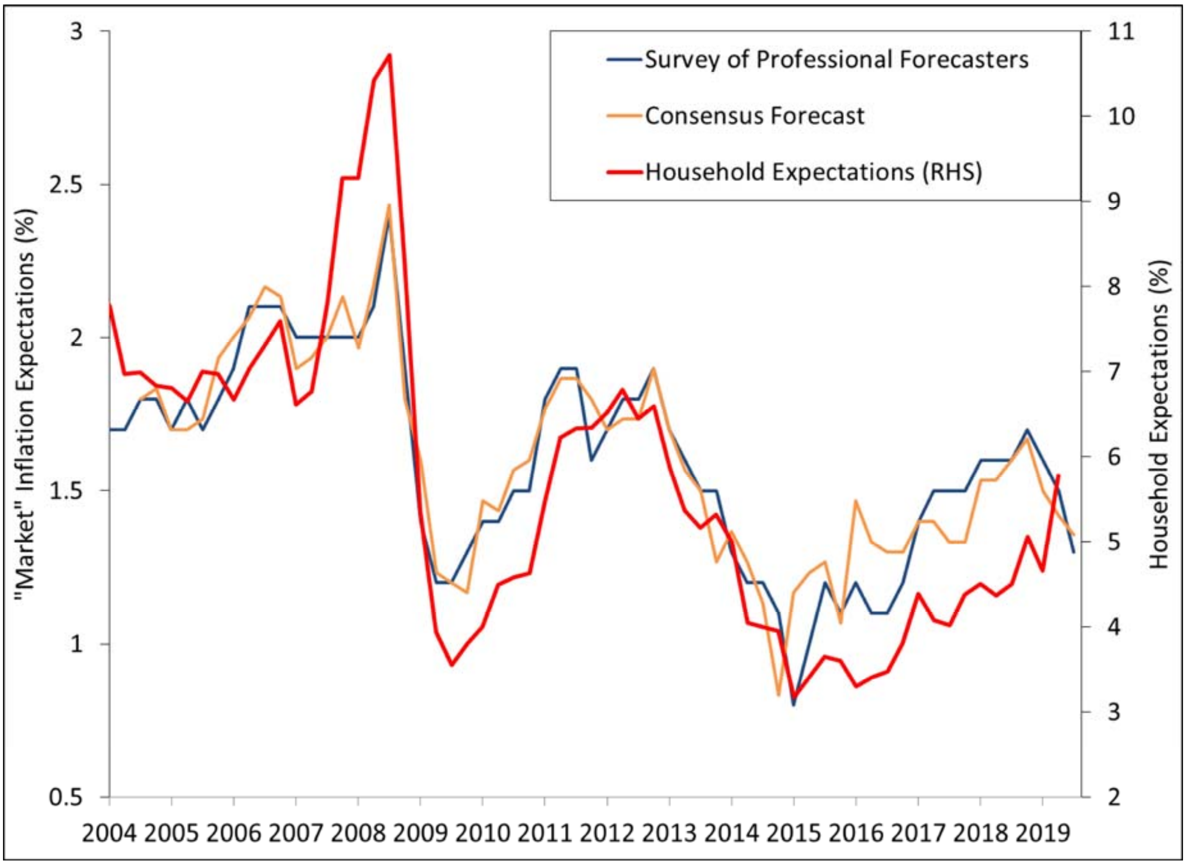
Figure 2. Households perceive quite well the overall evolution of inflation



Source: B. Coeuré (2019). Inflation expectations and the conduct of monetary policy, Speech at an event organised by the SAFE Policy center, 11 july 2019

Figure 3. Recent divergence between the evolution of household inflation expectations and market based-measures



Sources: ECB, European Commission