

Measuring expectations

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Abstract

Surveys of professionals, households and firms, market-based measures and their risk premia, and why households' expectations look nothing like the target.

Expectations are not observed; they are asked for or inferred. Each method measures a different group with different biases, and the differences are large enough to change the reading of whether the anchor from Anchored expectations is holding.

Surveys

Professional forecasters. The Philadelphia Fed's Survey of Professional Forecasters (since 1968) and the ECB's Survey of Professional Forecasters (since 1999) ask a few dozen economists for point forecasts and probability distributions at horizons up to ten years. Their long-run expectations are the best-behaved series available: close to target, slow-moving, narrowly dispersed. They are also the least informative about price setting, because forecasters do not set prices.

Households. The University of Michigan Surveys of Consumers (monthly since 1978) and the New York Fed's Survey of Consumer Expectations (since 2013) ask households what they expect inflation to be over the next year and over five years. Household expectations are systematically higher than realised inflation, widely dispersed, and strongly influenced by the prices people see most often, especially fuel and food. Weber and co-authors summarise a decade of evidence: households' expectations are biased upward, respond to salient prices, differ by demographic group, and nonetheless predict spending decisions (Weber et al., 2022).

Firms. Firms are the price setters and, until recently, the least surveyed. Coibion, Gorodnichenko and Kamdar reviewed the evidence and found that firms' inflation expectations resemble households' rather than professionals': inattentive, dispersed, and often far from the target, even in economies where the target had been met for years (Coibion et al., 2018). Central banks have since built firm surveys: the Atlanta Fed's Business Inflation Expectations, the Bank of Italy's, the ECB's SAFE.

Market-based measures

Break-even inflation is the difference between the yield on a nominal government bond and an inflation-indexed bond of the same maturity:

$$\text{BEI}_t^{(n)} = y_t^{(n)} - r_t^{(n)} = \mathbb{E}_t \bar{\pi}_{t,t+n} + \text{IRP}_t^{(n)} - \text{LP}_t^{(n)}. \quad (1)$$

The first term is the market's expected average inflation over n years, which is what the analyst wants; the other two are an inflation risk premium and a liquidity premium on the indexed bond. Both vary over time and can be large: in March 2020 US break-evens collapsed because indexed bonds became illiquid, not because expected inflation fell to 0.5 percent. **Inflation swaps** give a cleaner read at the cost of a smaller market.

Market measures are available daily and respond to news, which makes them the natural input to the event studies of Anchored expectations. Their weakness is that they reflect the marginal investor, whose expectations and risk appetite are not those of the median worker.

Why the gap matters

Measure	Typical level (US, 2010s)	Dispersion	Reacts to
SPF, 10-year	about 2.0–2.3 percent	narrow	little
Break-even, 10-year	1.5–2.5 percent	not applicable	news and premia
Michigan, 1-year	2.5–3.5 percent	wide	fuel, food, headlines
Michigan, 5–10-year	2.5–3.0 percent	wide	slowly
Firm surveys, 1-year	similar to households	wide	own costs

A central bank that reads only the first two rows concludes expectations are anchored at 2 percent. One that reads the last three concludes that the target has never been fully absorbed by the people who set prices, and that their expectations move with what they buy. Both readings are correct about their own group.

Practical guidance

- Use professional and market measures for the *level* and *sensitivity* tests of anchoring; use household and firm measures for the *transmission* to prices and wages.
- Watch the *change* in household expectations more than the level; the upward bias is roughly constant, the movements carry information.
- Correct break-evens for premia when possible, or at least compare with swaps.
- In the euro area, the ECB’s Consumer Expectations Survey (since 2020) filled the household gap; in Switzerland the SECO consumer survey and the SNB’s own company surveys serve the same purpose.

Communication shows what central banks can do about the household numbers; the answer is less than they would like.

Coibion, O., Gorodnichenko, Y., & Kamdar, R. (2018). The formation of expectations, inflation, and the Phillips curve. *Journal of Economic Literature*, 56(4), 1447–1491. <https://doi.org/10.1257/jel.20171300>

Weber, M., D’Acunto, F., Gorodnichenko, Y., & Coibion, O. (2022). The subjective inflation expectations of households and firms: Measurement, determinants, and implications. *Journal of Economic Perspectives*, 36(3), 157–184. <https://doi.org/10.1257/jep.36.3.157>