

Comments on
“Are Long-Run Inflation Expectations Anchored More
Firmly in the Euro Area than in the United States?”
by Meredith J. Beechey, Benjamin K. Johannsen, and Andrew T. Levin

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- The paper compares the evolution of long-run inflation expectations in the euro area and the US.
- Survey expectations from surveys of professional forecasters and expectations implicit in asset prices are considered.
- Mean survey expectations for both the US and the euro area inflation are found to be relatively stable, but there is more disagreement among the professional forecasters in the US.

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Summary

Effect of Macroeconomic News

- The effect of news is examined by means of the following regression model,

$$f_{n,t} - f_{n,t-1} = \alpha_n + \beta_n X_t + \varepsilon_{n,t},$$

where $f_{n,t} - f_{n,t-1}$ is the change from period $t - 1$ to t of a one-year forward rate (nominal or real) ending n years ahead, and X_t is a vector of news released on day t .

- The model is estimated for nominal and real forward rates for different horizons n .
- The news components are computed by subtracting the median survey expectation from the actual released value and standardizing by the standard deviation.

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- In the euro area, US news affects nominal rates but has no effect on inflation expectations implicit in the forward rates that are only affected by euro area news at short horizons.
- In the US, the surprise components of several US data releases have a significant effect on both the nominal rates and inflation expectations, even at long horizons.
- Two main conclusions are reached:
 - The long-run inflation expectations are more firmly anchored in the euro area than in the US.
 - A quantitative inflation target might be helpful in anchoring the inflation expectations in the US.

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- It is a good idea to present evidence based on “market expectations” in addition to survey expectations.
- The two series of survey expectations may not be directly comparable, because in the US survey, the forecast horizon is ten years, while in the euro area survey, the forecasts pertain to inflation over five years.
 - Because of the different forecast horizons, the greater dispersion among the US professional forecasters does not seem surprising.
- Survey expectations may be affected by forecasters’ incentives (see, e.g., Ottaviani and Sørensen (2006)).
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- The computation of the surprise component of data releases is based on the median of survey expectations from Money Market Services (MMS) for the US and Bloomberg for the euro area data releases.
- It is not clear whether the survey expectations capture all information available immediately before the announcement. There is prior evidence that MMS expectations are unbiased and not stale, but this need not be the case for the Bloomberg expectations.
 - Differences in the survey expectations may help explain the different results for the euro area and the US.
 - Balduzzi et al. (1998) suggest checking this by regressing the actual announcement i , A_{it} , on a constant, the median survey expectation, F_{it} , and the change of $f_{n,t} - f_{n,t-1}$ between the survey and the announcement,

$$A_{it} = \alpha_{0i} + \alpha_{1i}F_{it} + \alpha_{2i}\Delta(f_{n,t} - f_{n,t-1}) + e_{it}.$$

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- The analysis is based on daily data, which may make it difficult to identify the effects of different data releases as there are often days with multiple data releases.
- The error term in the regression model is assumed to be i.i.d.
 - There is evidence from other markets that macroeconomic news also affects volatility. If these effects are present, but they are precluded from the model, the model may be misspecified.
 - Conditional heteroskedasticity could be allowed for by weighted least squares estimation (see, e.g., Andersen et al. (2003)).
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- For the US news, the effects are found to persist for several days.
- There is also prior evidence from e.g. the foreign exchange markets that news effects are not absorbed very quickly (Evans and Lyons (2005)).
- If the news has a prolonged effect, a preferable approach might be the estimation of a model with current as well as lagged release surprise components as explanatory variables.
 - In this case, the simple model with only the current news would be misspecified.
 - This would allow for conveniently testing for the importance of market liquidity.
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