The Daily Dish

The Fed and Inflation Expectations

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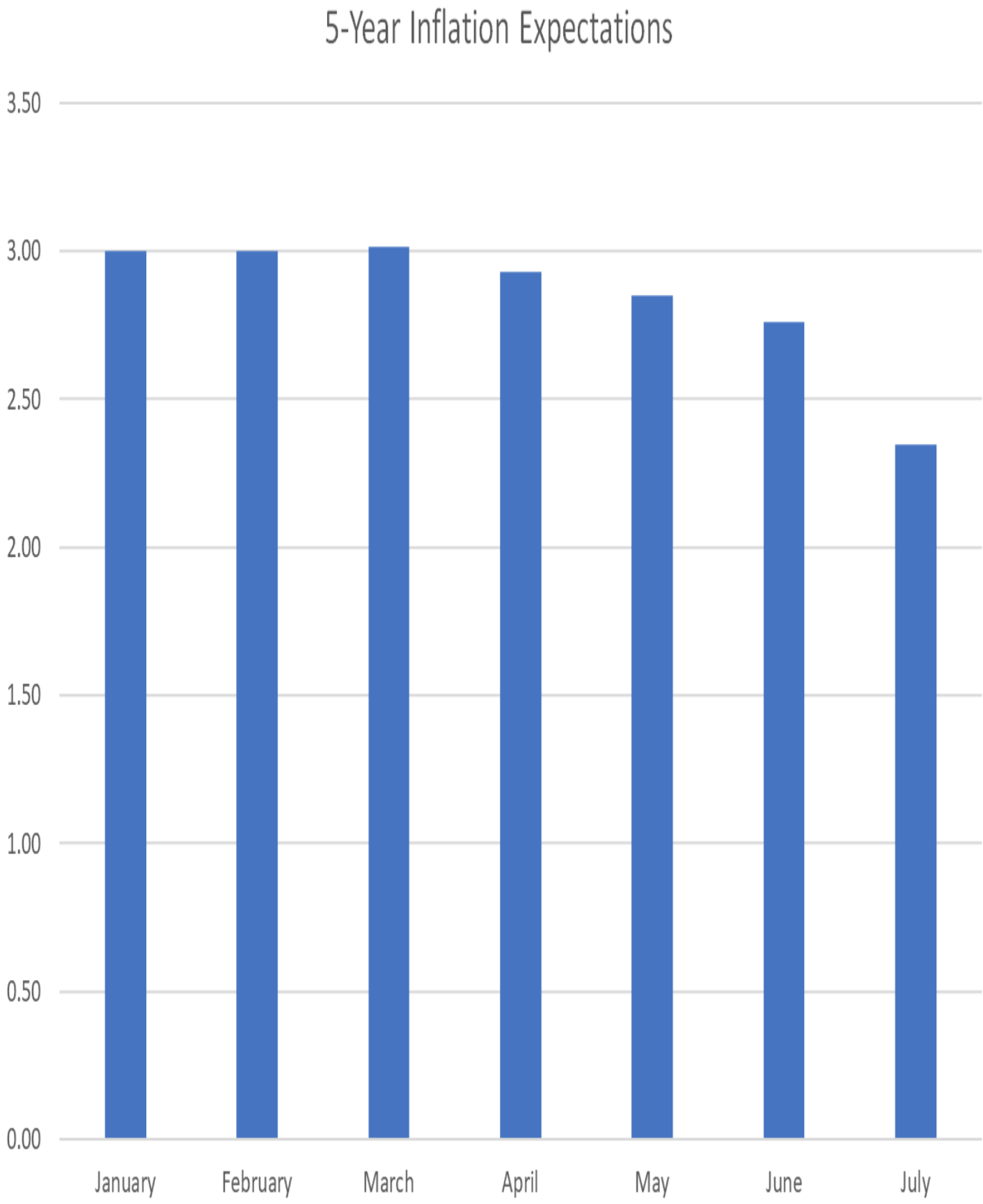
Since the Federal Reserve got serious about controlling inflation at the start of 2022, a key part of the battle has been to convince households, businesses, and market participants that it would be successful in reducing inflation to its 2 percent target.

Yesterday, the New York Federal Reserve Bank gave us some news on this front. Median five-year ahead inflation expectations (shown in the graph at the bottom) declined to 2.3 percent from 2.8 percent in June. Overall, after being stuck at 3.0 percent for the first quarter, the series has been declining since.

More immediately, the (median) one-year and three-year expectations both dropped fairly sharply in July. For one year the decline is from 6.8 percent to 6.2 percent, while for three years the decline is from 3.6 percent to 3.2 percent. The New York Fed press release also noted that: “Both decreases were broad based across income groups, but largest among respondents with annual household incomes under $50k and respondents with no more than a high school education.”

This represents progress. To the extent that individuals feel confident that there will be no inflation, they will not pre-emptively bargain for higher wages and thus guarantee some upward pressure on prices from labor costs.

So far so good on this front. But the real test is the behavior of actual inflation itself. We will get another read on this tomorrow morning when the Bureau of Labor Statistics releases the July data on the Consumer Price Index. The recent declines in global oil prices, gasoline, and food prices practically guarantee a decline from the 9.1 percent (year-over-year) inflation reported in June. But the real test is whether core (non-food, non-energy) prices decline from the 5.9 percent rate last month.


5-Year Inflation Expectations
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
January
February
March
April
May
June
July