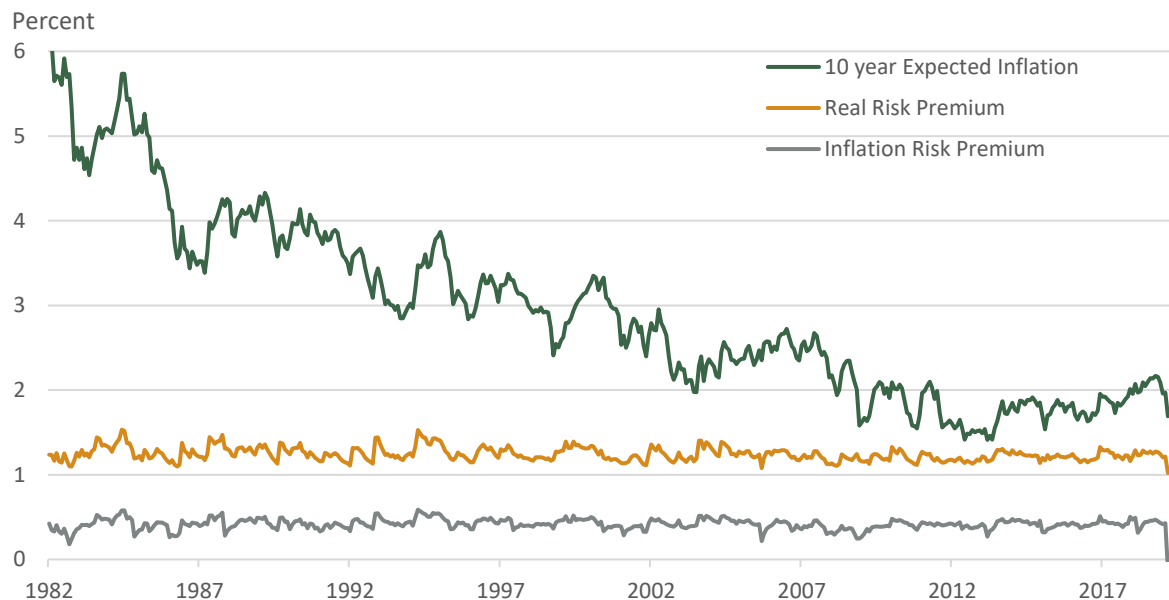


Inflation expectations have declined

... encouraging looser monetary policy in the major economies

US ten-year expected inflation and risk premia



Source: Federal Reserve Bank of Cleveland

- A number of the major central banks have latterly adopted a more dovish tone in their forward guidance.
 - Some central banks, including the RBNZ and RBA have already eased.
 - It is now widely expected that the Fed and the ECB will also loosen policy over the next few weeks.
 - Others may follow.
- A primary reason for the change in rhetoric is that consumer price inflation, and in particular measures of underlying consumer price inflation, have tended consistently to run below expectations and mandated targets.
- Perhaps more importantly, however, has been a decline in estimated long-term inflation expectations.
- In the US, the Cleveland Fed regularly publishes a comprehensive measure of ten-year US inflation expectations calculated using Treasury yields, inflation swaps, inflation data, and survey data. It shows that:
 - Inflation expectations have trended down consistently since the Volcker era;
 - They have struggled to match the Fed's 2% inflation target since the last crisis; and moreover,
 - Latterly there has been a significant dip, led in particular by a hitherto unparalleled drop in the inflation risk premium, or the degree of uncertainty about future inflation.
- The worry for policymakers in such circumstances is that low inflation becomes a self-fulfilling prophesy.
- There is also a concern that the leeway available to cut real interest rates in the event of a downturn is constrained. ■