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A Look at Atlanta Fed Resources

Hitting the Target: Inflation Expectations and Monetary Policy

Low and moderate price change is the implicit goal of the Federal Reserve's price stability mandate. In pursuing this objective, it's helpful for policymakers to consider many indicators of future price change, including inflation expectations.

A well-established measure of household inflation expectations currently exists in the survey conducted by the University of Michigan, but, curiously, no similar measure existed for businesses, until recently. Federal Reserve Chairman Ben Bernanke mentioned this deficiency in his speech at the National Bureau of Economic Research's 2007 Summer Institute:

> Information on the price expectations of businesses—who are, after all, the price setters in the first instance—as well as information on nominal wage expectations is particularly scarce. …[Further,] how do changes in various measures of inflation expectations feed through to actual pricing behavior?

The Atlanta Fed offers one remedy with the Business Inflation Expectations (BIE) survey. This monthly online survey is designed to gauge the general business conditions and inflationary sentiments of southeastern businesses. A panel of approximately 350 executives and business owners receive the survey each month.

Information gathered from our panel allows Atlanta Fed researchers to assess the inflation expectations and inflation uncertainty of businesses. Panelists also weigh in on their current sales levels and margins, as well as anticipated sources of price pressure in the coming year.

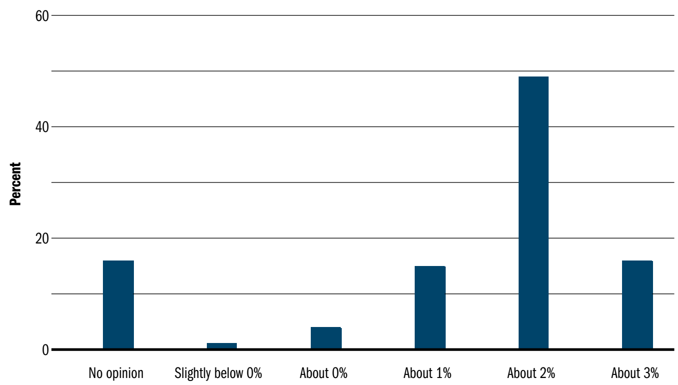
In addition to gauging firms' price-setting environment and expected changes to year-ahead unit costs, the survey investigates issues of longer-term interest for research and policy by asking a special question each month. For example, last October's special question showed that 49 percent of respondents understood the Federal Reserve's long-term inflation target to be 2 percent (see chart 1). Significantly, this survey was conducted prior to the Federal Open Market Committee's (FOMC) announcement in January of an official inflation rate target of 2 percent.

Another recurring special question asked at the beginning of each quarter will gauge firms' inflation expectations over the longer term (annually over the next five to 10 years), providing some indication of whether firms' inflation expectations are as well anchored over a longer time horizon.

Thus far, survey results show that although the distribution of near-term (the next 12 months) and longer-term inflation expectations are centered on the Federal Reserve's 2 percent target, there is an expectation of greater upside risk with respect to long-term inflation and greater downside risk with respect to near-term inflation (see chart 2). The FOMC's inflation rate goal is a long-run

Chart 1

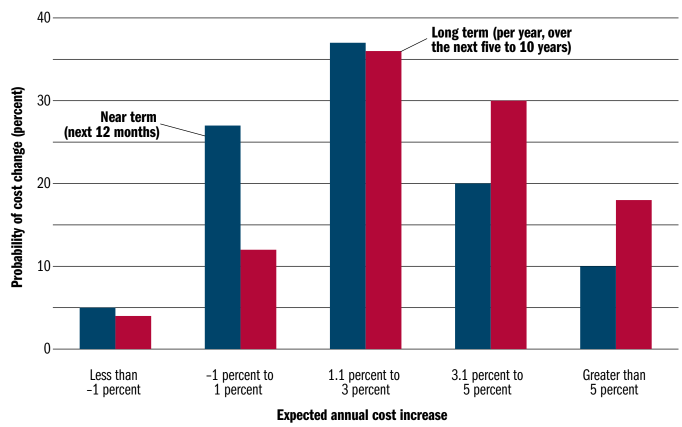
Businesses' Awareness of Long-Run Inflation Target



Source: Federal Reserve Bank of Atlanta

Chart 2

Distribution of Respondent Expectations for Unit Costs



Note: The survey reflects responses of Sixth District firms to the Survey of Business Inflation Expectations between April 9–13, 2012.
Source: Federal Reserve Bank of Atlanta

objective, so the discovery of greater upside risk over the long term is noteworthy.

The survey will continue to explore more aspects of firms' pricing decisions and the environment in which these decisions are made as a means of better understanding the likelihood of inflation and how cost increases are passed on to consumers. To follow its progress and view current and historical summaries of its results, visit the Business Inflation Expectations Survey page on the Atlanta Fed website at frbatlanta.org/research/inflationproject/bie. ∎

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