Discussion of the Survey of Professional Forecasters' Long-Term Forecast for Inflation

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Since 1991, the Philadelphia Fed's *Survey of Professional Forecasters* has asked a panel of forecasters about their views on long-term inflation. The survey, which is conducted quarterly and also includes forecasts for a variety of other economic variables, asks the panelists for their projections of the annual average rate of growth in the Consumer Price Index (CPI) over the next 10 years. The most recent survey (2004:Q2) showed the median forecast holding steady at 2.5 percent. That is the same rate the panelists have been projecting since the late 1990s. Using the data that are available on our web page, **Figure 1** shows the mean and median forecasts over the entire period for which we have responses.[1] (These responses are plotted at the survey date.) The figure also plots the lower and upper quartiles, which are the 25th and 75th percentile responses. If we focus on the median, we see that expectations for long-term inflation are far from constant over the entire sample. Over the period from the early 1990s to the late 1990s, the forecasters gradually cut their projection from about 4 percent to 2.5 percent. Since the late 1990s, however, the median response has held relatively constant. The mean response follows a similar pattern.

Recently, one prominent analyst wondered whether the survey's responses might be plagued by a composition effect that would complicate the comparison of one survey's responses with another's.[2] This question is of particular interest in the recent surveys, which were conducted during a period in which the economy experienced robust growth, actual CPI inflation rose, and the financial press worried about higher inflation. Although our survey's panel has remained surprisingly constant in recent years, the number of participants does change from survey to survey. This suggests that any comparison of one survey's results with another's could reflect not only the changing views of those who participated in both surveys but also a changing mix of forecasters. Using the data available on our web page, we investigated whether we could construct an experimental panel of forecasters that would contain the same forecasters in each of the last few years of surveys, going back to 1999. Such a panel could then be used to assess the long-term inflation forecasts without having to worry about how a changing mix of forecasters might be affecting the results. Our investigation showed that no panelist participated in each of the last 22 surveys, three participated in 21 of the last 22 surveys, and only six participated in 20 of the last 22 surveys. If we were willing to construct the new, experimental panel based only on those who missed fewer than three of the past 22 surveys, the panel would have just nine forecasters, arguably too small to construct a reliable alternative summary measure of the survey's long-term inflation projections.

Given the recent relative stability of the median forecasts, we also investigated whether the median is masking any interesting variation in the underlying responses of the individuals. In

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[1] The data in this report are available on our web page: http://www.phil.frb.org/econ/spf/index.html .

[2] We thank Ken Matheny of Macroeconomic Advisers, LLC, for raising this issue.

other words, over the period since the late 1990s, have some forecasters changed their views on the long-run outlook for inflation? Or are all holding their projections constant at about 2.5 percent? Our investigation showed that some forecasters have adjusted their projections quite a bit. Interestingly, only one forecaster has held his long-run projection steady at the survey median over most of the period. Over the past few surveys, a handful of forecasters have raised their long-term projection for inflation. **Figure 2** shows the responses of the forecaster (#428) who has held his forecast steady at the survey's median of 2.5 percent. For perspective, the figure also plots the lower and upper quartiles. **Figure 3** shows the responses of another forecaster who has recently raised his projection. The data also show that some forecasters have cut their expectations for long-term inflation in recent surveys.[3]

The relative stability of the survey's median response for inflation over the next 10 years should not be taken as an indication that each forecaster is holding his projection constant. Over the period since the late 1990s, the forecasters have changed their views. Over the last few surveys, some have raised their forecasts, while others have held the line or even cut their forecasts.

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[3] Because of the confidentiality agreement we have with our panelists, we are unable to provide the names of the forecasters associated with the identification numbers shown in the figures. The data available on our web page are coded with these identification numbers.

Figure 1. Long-Term Inflation Forecasts

Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia.

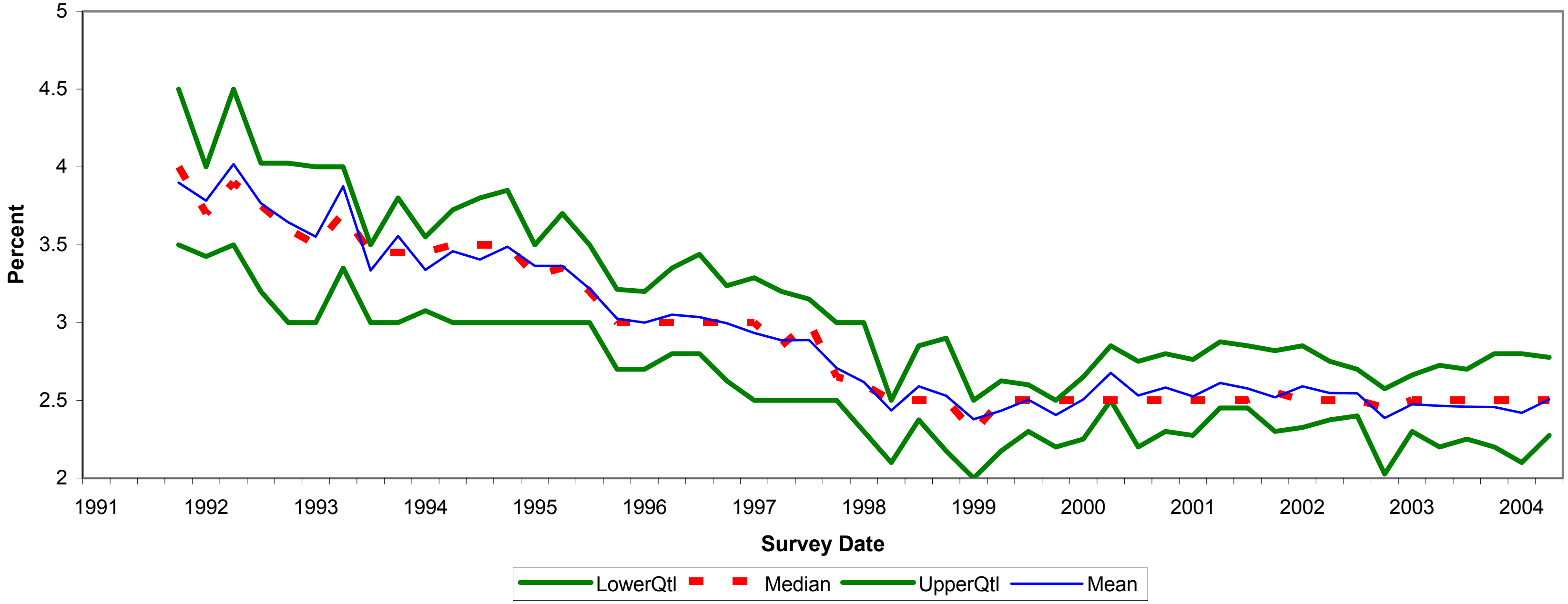
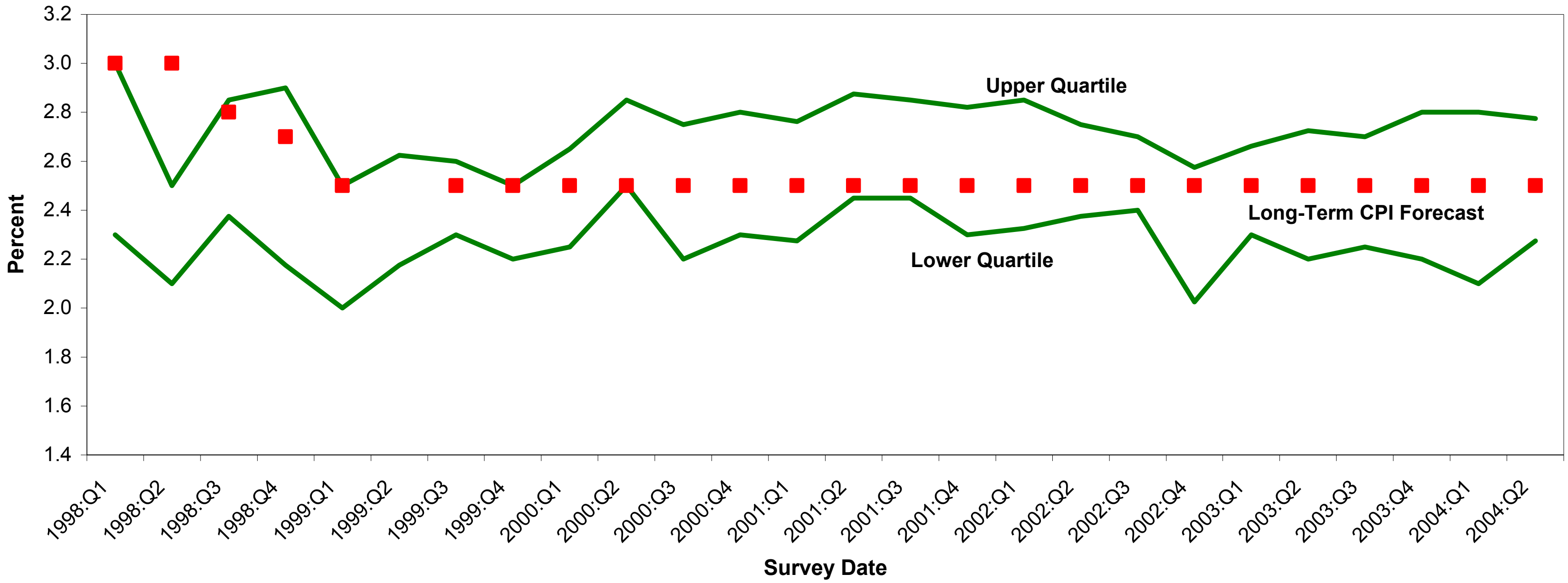
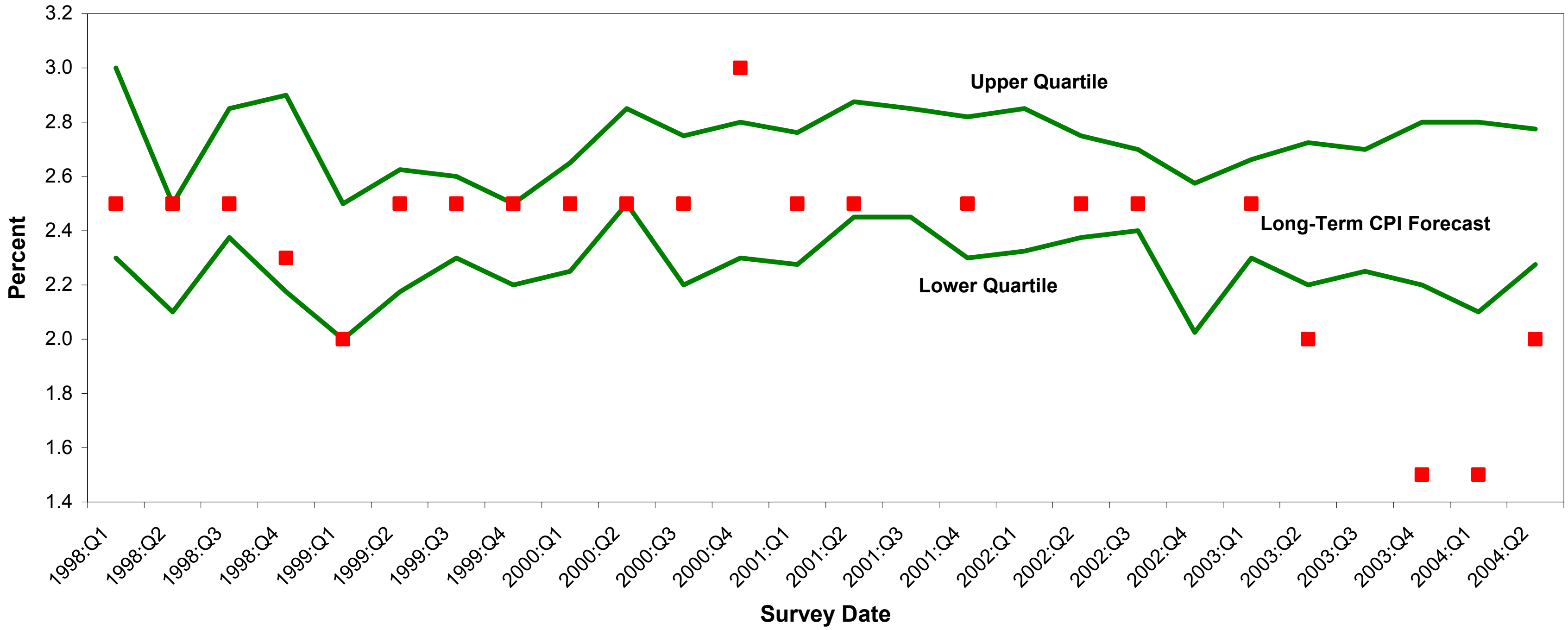


Figure 2. Long-Term Inflation Forecast
Panelist 428



Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia.

Figure 3. Long-Term Inflation Forecast
Panelist 456



Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia.