There is a famous theorem in sociology called Thomas Theorem, formulated as “If men define situations as real, they are real in their consequences.” It is a perfect sentence to describe the inflation expectation. If a firm expect a higher price of inputs in the future, than it will set a higher price of outputs now because the price has to stay fixed for years. If a worker expects a higher price of consumption in the future, he will sign a contract that has higher wage now because the contract will last for years. This positive feedback loop causes the fact that expectation of higher prices in the future actually leads to higher prices in current period. Therefore, the function of central bank to control inflation expectation plays such an important role in controlling actual inflation. However, the anchoring of inflation expectation does not perform very well the whole time, many temporary shock in US or even in the world history has led to long-term inflation.

Thus, it is imperative to evaluate the inflation expectation anchoring as an indicator of credibility of the central bank. And it is also beneficial to make comparisons cross-time and cross-countries to get some deep insights. These are the study questions that the Davis and Mack paper (2013) wants to tackle with. First, the authors use the regression of 5-year-5-year-forward expected inflation rate on the discrepancy between expected and actual inflation to gauge the US inflation expectation anchoring overtime. They find the US inflation expectation is not well anchored in the 80s, but it is better anchored now. Because the 5-year-5-year-forward expected inflation rate is not available in many countries, in order to make cross-country comparisons, the authors derived a Phillips curve regression that turns the inflation expectation response function into a function of inflation with regards to its lag terms and growth rate in industrial production. In this regression on US inflation data, the authors get similar results as the 5-year-5-year-forward expected inflation rate regression, so it is proved to be a valid way to measure the inflation expectation anchoring. Then the authors applied this method on 64 countries and calculate their estimated anchoring. They found the results are consistent with the intuition that the high credibility central bank countries are well anchored, and low credibility central bank countries are not well anchored, and the results hold for both headline inflation and core inflation. Finally, the authors use rolling-window regression to show the changes in the inflation expectation anchoring overtime for US, Canada, Mexico, UK and twelve first euro-zone countries. They find out that the oil crises in the 1970s has made most the of the countries unanchored, but after a series of inflation targeting and independence of central bank, most countries’ central bank regained their credibility and re-anchored the inflation expectation again.

Their paper is consistent with many former researches which study the inflation expectation anchoring cross-time and cross-country.

Clark and Davig paper (2011) study the volatility and responsiveness of US inflation expectation over time. It estimates a VAR model with stochastic volatility and decomposing the decline in expectations volatility. The authors find out that the volatility in inflation expectation is decreasing over time, and the factors that drive the volatility has changed from shocks in inflation expectations itself to the actual inflation. This means that the inflation expectation is better anchored than before. They suggest that this is due to a shift in monetary policy towards more systematic behavior.

Beechey, Johannsen, and Levin paper (2011) compares the long-run inflation expectation anchoring between US and euro area. They use the regression of inflation compensation, which is derived from inflation swaps, with regards to some surprise components of macroeconomic data. Their results are that both long-run inflation expectation of US and euro countries are well anchored in recent years, but the one in euro area is anchored more firmly than in US. The authors ascribe the difference to the difference in communication practices between European Central Bank and Federal Reserve. So they suggest that announcing a quantitative inflation target can help US have a firmer inflation expectation anchoring.

Gürkaynak, Levin, and Swanson paper (2006) compares long-run inflation expectation anchoring between inflation targeters UK and Sweden and non-inflation-targeter US. They examine how much the inflation compensation, which is defined as the difference between far-ahead forward rates on nominal and inflation-indexed bonds, moves in response to macroeconomic data releases and monetary policy announcements. They find that the inflation compensation in Sweden is not sensitive to the news the whole time; in UK it is not sensitive after the independence of Bank of England, while the in the US it is quite sensitive the whole time. This paper reaffirms the importance of inflation targeting and central bank credibility in inflation expectation anchoring.