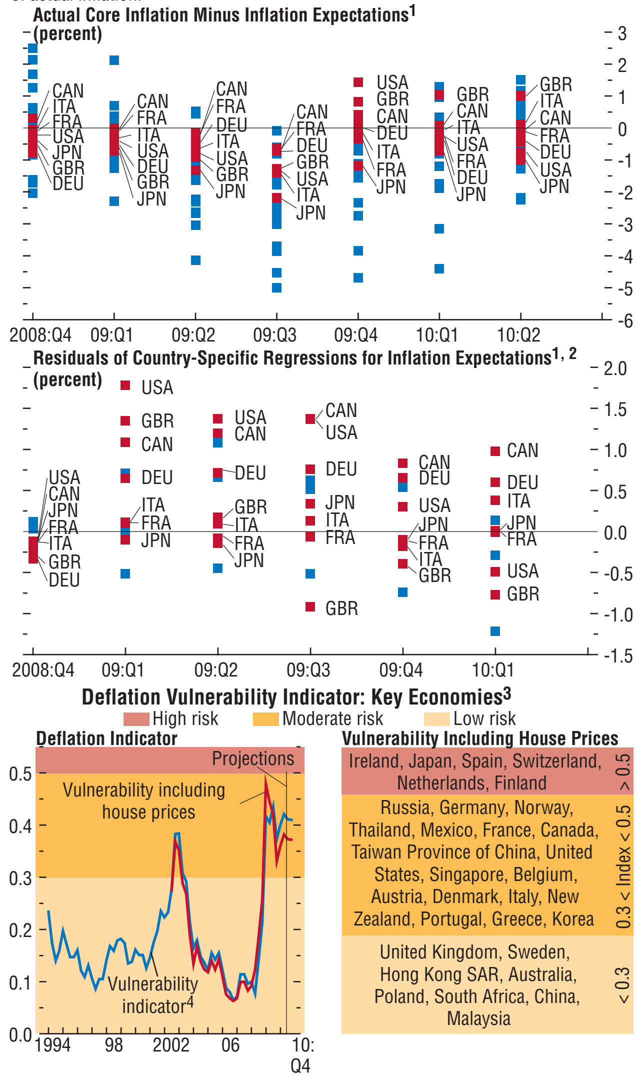
Figure 1.16. Inflation, Deflation Risk, and Unemployment

Short-term *Consensus Forecasts* inflation expectations have overshot actual inflation by substantial margins. They have also been higher than indicated by past relationships with various fundamental determinants. This is surprising, as IMF staff analysis suggests that deflation rather than high inflation is the more pertinent risk. Assuming that these short-term expectations are representative of those in the broader economy, their stickiness may explain part of the stickiness of actual inflation.



Sources: Bloomberg Financial Markets; Haver Analytics; and IMF staff calculations.

[1]CAN: Canada; FRA: France; DEU: Germany; ITA: Italy; JPN: Japan; GBR: United Kingdom; USA: United States.

[2]The residuals are differences between actual one-year-ahead Consensus inflation expectations and out-of-sample forecasts of these expectations. The forecasts are obtained from regressions of one-year-ahead Consensus inflation expectations on lagged values of these expectations, Consensus expectations for unemployment rates, WEO expectations for output gaps, oil price growth rates, and long-term Consensus expectations for inflation. The regression samples typically cover 1999:Q1 to 2008:Q4. Positive residuals suggest that short-term Consensus expectations have been higher than could have been expected given their past relationship with unemployment rates, output gaps, oil prices, and long-term Consensus expectations.

[3]For details on the construction of this indicator, see Kumar and others (2003) and Decressin and Laxton (2009). The figure also features an expanded indicator, which includes house prices. Vulnerability is as of 2010:Q2.

[4]Major advanced and emerging economies.