Forward information and macroeconomic persistence: What else can we learn from survey expectations?

This study proposes two novel ideas about the expectations formation process which are found to be strongly related. Our first idea is that the underlying model used by forecasters could be recovered from data of survey forecasts. We apply this idea to the estimation of inflation persistence, based on the cross-sectional variation in multi-horizon inflation forecasts. Our approach enables to track inflation persistence quarter-by-quarter, based on recent responses of survey participants. Applying our measure to the Survey of Professional Forecasters, we find a gradual decline in inflation persistence over the last decades, from the maximum degree of 1 to about 0.5. Our findings offer a compromise in the debate about whether inflation persistence in the US dropped dramatically or didn't change at all. However, we present several empirical patterns, related to our persistence measure, which are not consistent with prominent models of expectations formation and propose a new approach. We deviate from recent models of expectations and suggest that forecast disagreement and predictable errors could arise due to an advantage rather than a deficiency in expectations. This advantage is based on forward information in the form of informative signals about the future. Forecasters adjust their model-based predictions to account for new available forward signals. We show this framework could account for all the puzzling patterns found in the SPF data, which indicates on the usage of forward information available to forecasters up to around a year ahead. We further decompose expectations to their two components and present direct evidence for the presence of forward information. Lastly, we propose to apply the forward information component to the estimation of news shocks and their role in the business cycle.