
Essentially the article by Mishkin looks at the changing dynamics of inflation, which the author concludes has come about because of an anchoring of inflation expectations. As the article title “Inflation Dynamics” suggests, the changing dynamics of inflation are quite important to the author and the conclusion made that expectations play an important role in inflation. So, the changing dynamics Mishkin identifies are:

1. **The decline in inflation persistence**
   Mishkin cites work by Stock and Watson (2007). Stock & Watson split inflation into two components: 1) an underlying trend inflation, so shocks to this component continue indefinitely; and 2) uncorrelated shocks, which are temporary. Charting the standard deviations of these two inflations – displayed in Table 1 on p2. – the trend component rises in the period of high inflation in the 70s and 80s, but has declined since. So, inflation in the ’70s and ’80s occurred when the trend inflation became “un-anchored”, but in the ’90s trend inflation has become “re-anchored”.

The second changed inflation dynamic is the **2. flattening of the Phillips curve** (less trade-off between inflation and unemployment, so tight labour market isn’t leading to higher inflation); and the third changed inflation dynamic is that **3. inflation has become less responsive to shocks** (shocks have less impact and tend to wash out quickly).

**Essential conclusion**
The conclusion Mishkin draws from his discussion of the above three points (the decline in the persistence of inflation, the flattening of the Phillip’s curve, and the decline of CPI responsiveness to shocks) is that there has been the re-anchoring of inflation expectations. The un-anchoring and the re-anchoring of trend inflation in recent years is explained by a re-anchoring of expectations in recent years. **Chart 2 on p2.** shows the relationship between trend inflation and actual inflation.

**Discussion**
On the plus side, Mishkin shows the key role of expectations in inflation, and makes a convincing case of the importance of expectations in inflation. This has some important policy implications (which Mishkin discusses), such as the need for central bank credibility (to anchor expectations) among others.

On the minus side, the author does not consider other influences on the changing nature of inflation which may explain the changing dynamics of inflation which the author observes. For example, better monetary policy (not quite true, Mishkin believes better monetary policy has resulted in anchoring inflation). In addition, the relationships are correlations and do not imply causation (which Mishkin points out). Lastly, there is very limited discussion of the process whereby inflation expectations determines actual inflation (such as employees negotiating smaller pay increases to much lower inflation, lower prices because shopkeepers anticipate less inflation, etc).

These charts are copied and pasted the reading:

**Chart 1 – Stock-Watson (2007)**

Core PCE Inflation: Estimates from the Stock-Watson UC/SV Model

A. Standard deviation of innovations

![Chart 1](image1)

**Chart 2: Inflation expectation (FRB/US – dotted line) and actual Stock-Watson trend inflation (solid line)**

![Chart 2](image2)

*Note: The FRB/US expectations series splices readings on expected long-run inflation from the Hecy survey (1981–1992) and the Survey of Professional Forecasters (1991–present). A constant adjustment factor of 1/2 percentage point is subtracted from both the Livingston survey and the FRB/US measure to control for the average historical difference between CPI and PCE inflation.*