



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Recent developments in marked-based indicators of inflation expectations

ECB Bond Market Contact Group

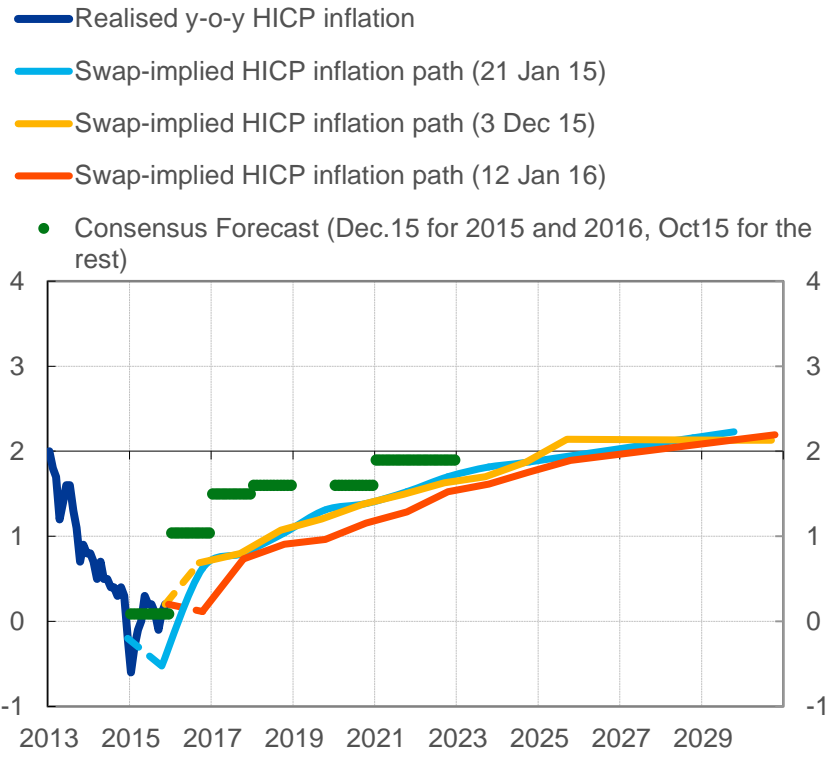
19 January 2016

Key messages:

- Market-based indicators of inflation expectations are strongly affected by movements in the inflation risk premium
- The declining trend in longer-term inflation swap rates seen in the second part of 2014 has been stopped
- Deflation risk derived from inflation options remains low

Expected path of inflation

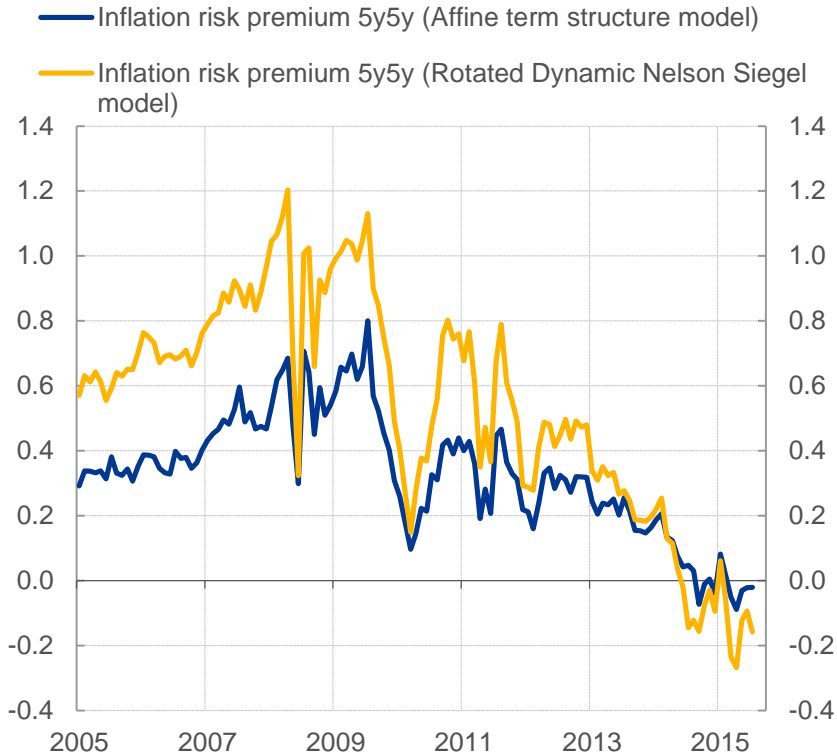
(percentages per annum)



Sources: Consensus Economics, ECB and Thomson Reuters.
 Note: The latest observation is for 12 January 2016.

Model estimates of the inflation risk premium

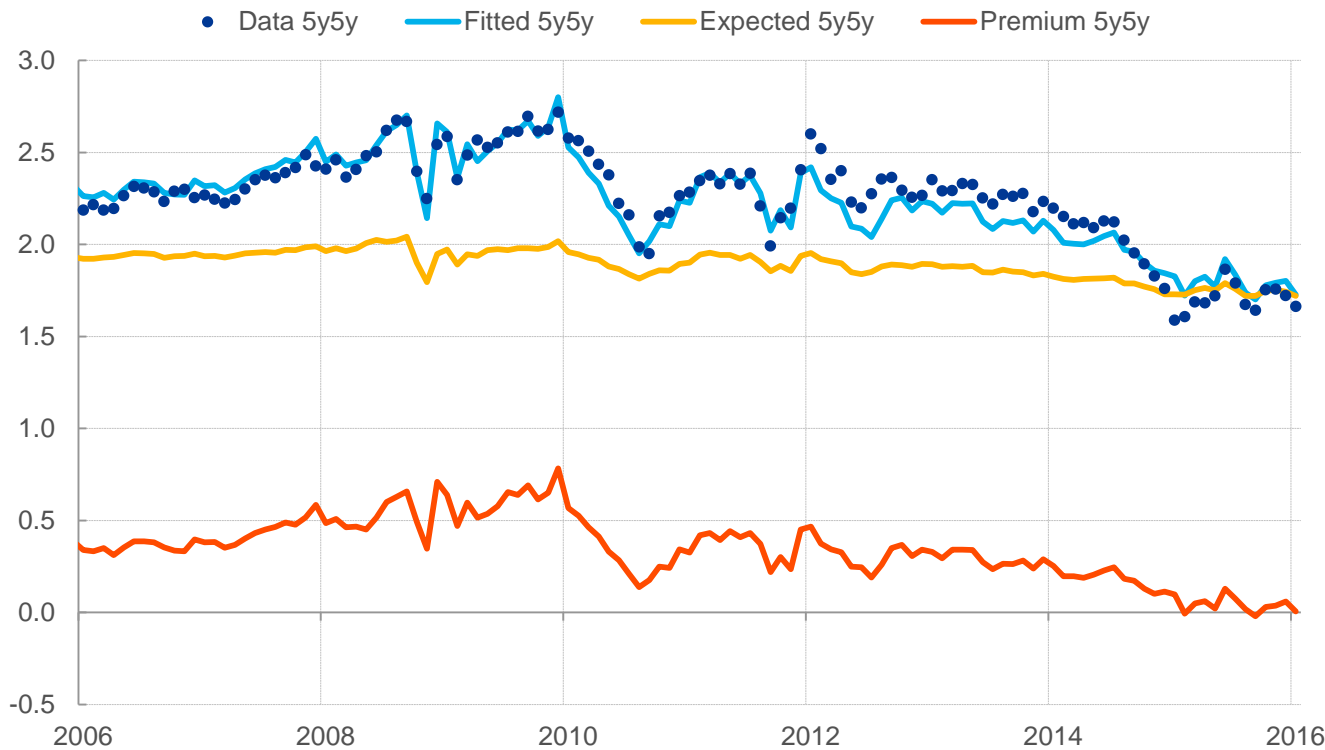
(percentages per annum)



Sources: ECB and Thomson Reuters.
 Notes: The blue line shows the premium estimate from and ATSM (Affine term structure model), and the yellow line shows the estimate from a Rotated Dynamic Nelson-Siegel model. Both models are fitted to the euro area zero-coupon inflation linked swap curve.

Last observation: December 2015.

Model based decomposition of 5y5y rates into premium and expectations (percentages per annum)



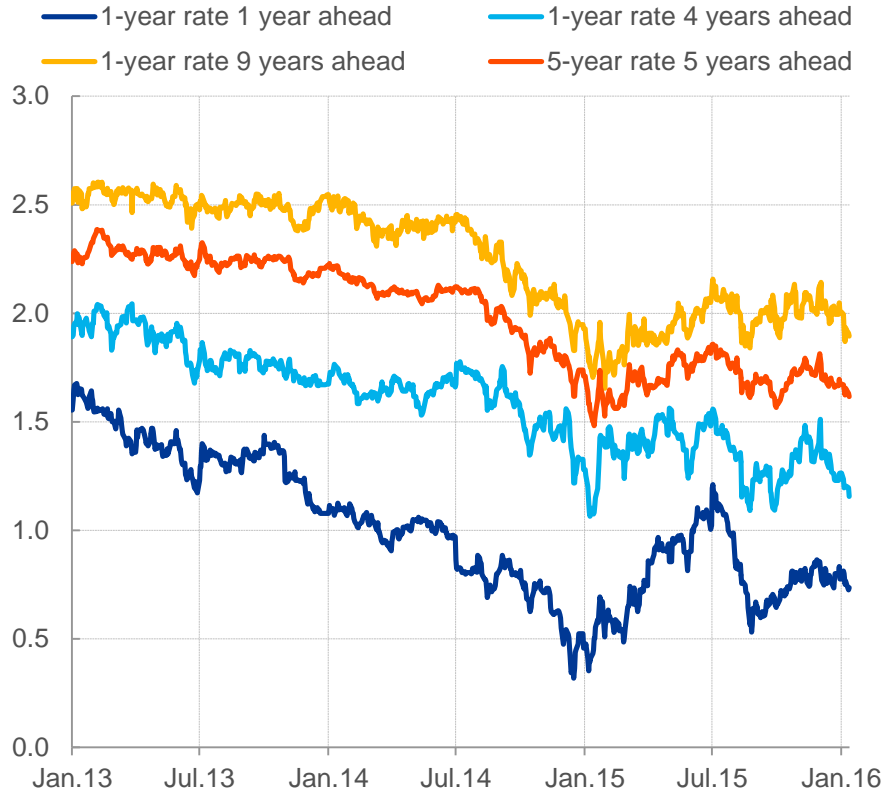
Sources: ECB and Thomson Reuters.
Notes: Decomposition based on an ATSM (Affine term structure model) fitted to the euro area zero-coupon inflation linked swap curve. The estimation method follows Joslin, Singleton and Zhu (2011).

Last observation: January 2016

The declining trend of longer-term inflation swap rates has been stopped

Forward inflation-linked swap rates

(percentages per annum)



Sources: Thomson Reuters and ECB calculations.

Notes: Vertical line denotes last GC meeting on 3 December 2015. The latest observation is for 12 January 2016.

Years for euro area inflation to reach

2%

(years)

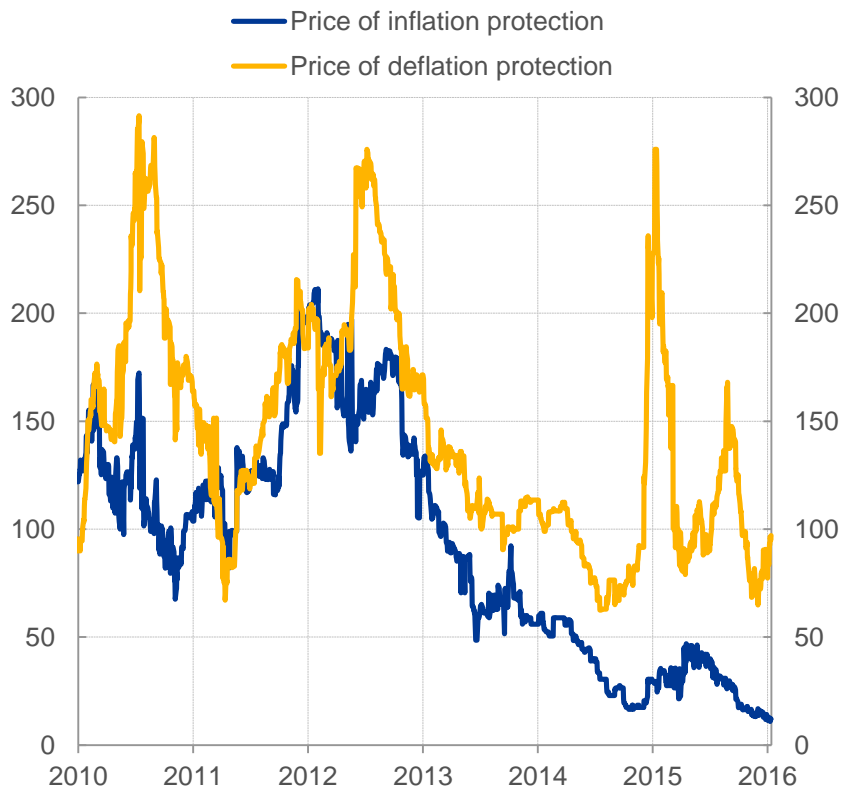


Sources: Thomson Reuters and ECB calculations.

Notes: The index referenced is the HICP ex tobacco that historically has been around 0.1% lower than HICP.

The latest observation is for 12 January 2016.

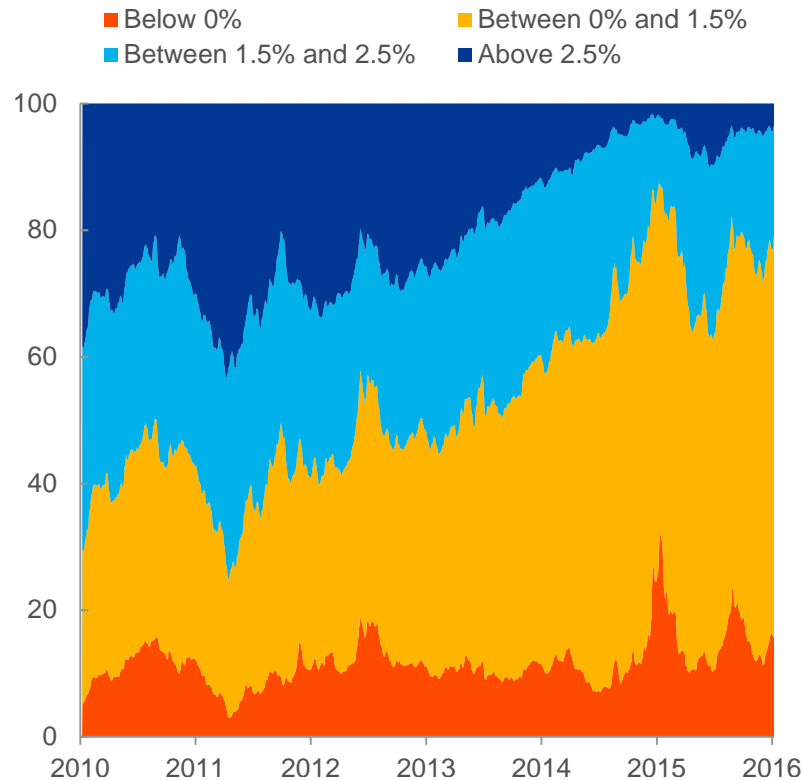
Price of inflation/deflation protection (basis points)



Sources: Thomson Reuters and ECB calculations.

Notes: Price of inflation (deflation) protection refers to the price of a year-on-year inflation option with a 4% cap (0% floor) for a horizon of five years. The latest observation is for 12 January 2016.

Option-implied risk-neutral distribution of inflation expectations (percentages)



Sources: Bloomberg, Reuters and ECB calculations.

Notes: Probabilities implied by five-year zero-coupon inflation options. Risk-neutral probabilities may differ significantly from physical, or true, probabilities. The latest observation is for 12 January 2016.