4/21 Saleem's title+abstract:

Title: The Market for Inflation Risk

Abstract: Markets for inflation swaps allow agents to trade inflation risk and provide measures of expected inflation that are contaminated by liquidity frictions, risk premia, and reflect an aggregate of the beliefs of different market participants with varying influences. This paper uses transaction-level data on the universe of traded inflation swaps to characterize who buys and sells inflation risk, when, and with what price elasticity, and to extract expected inflation from observed market prices. We first show that this market is segmented: banks and pensions funds trade at long horizons, while banks and hedge funds trade at short horizons. This segmentation suggests three identification strategies—sign restrictions, a granular instrumental variable, and heteroskedasticity—for the demand curves by different groups in this market. Across the three strategies we find that
(i) hedge funds are more price sensitive than pension funds,
(ii) market prices absorb new information within three days,
(iii) fundamental shocks drive long-run prices, while liquidity shocks associated with hedge funds drive short-run prices,
(iv) short-horizon expected inflation is not a reliable measure of expected inflation,
(vi) long-horizon expected inflation is useful, and at the starts of 2023 it is lower and is falling more rapidly than conventional measures.