

The aim of the study is to verify the impact of fiscal Policy on inflation expectations of consumers and professional forecasters in selected European Union economies. According to the fiscal theory of the price level, intertemporal budget constraint of the government can be satisfied in two ways – either by generating budget surpluses in order to finance current public debt (monetary dominance regime) or by the increase of prices (fiscal dominance regime). Since the beginning of the recent financial crisis, Europe has been confronted with the debt crisis, whose scale has been rising. The increase of public debt, implying the risk that the budget constraint will be satisfied via an increase of the price level, should exert influence on inflation expectations of the public, given that economic agents understand mechanism of this kind. Therefore, according to our hypothesis inspired by the fiscal theory of the price level, higher public debt should make inflation expectations of the public increase. Such an effect however should be diversified among countries due to two factors, i.e. the existence of fiscal dominance and the level of inflation. There will be three principal stages of our research. Within the first one we will quantify consumer inflation expectations in 20 EU economies (those for which survey data on inflation expectations are available) with the probability method. Then we will identify the economies characterized by fiscal dominance in the period under analysis. We will use the Bohn (1998) test for fiscal dominance, based on a long-run relationship between a lagged public debt-to-GDP ratio and the primary balance of the budget expressed as a percentage of GDP. Within the last stage of the research we will estimate models of formation of inflation expectations of consumers and professional forecasters. Among explanatory variables they will contain the public debt, among others. The impact of the public debt on inflation expectations will be controlled for a possible existence of fiscal dominance and for the inflation regime (low/negative vs. high inflation). The analysis will be conducted both on individual country data and panel data.

The results of the proposed study will expand the economic knowledge in the following areas:

- verification of the existence of the fiscal dominance phenomenon in a large group of the European economies with the sample covering the period of the recent financial crisis;
- better understanding of the model of formation of inflation expectations in the analysed economies;
- empirical verification of the fiscal theory of the price level from the point of view of inflation expectations of consumers and professional forecasters and, if the impact of public debt on inflation expectations occurs statistically significant, identifying an additional channel, through which fiscal policy can influence inflation;
- assessment if in the environment of low or negative inflation fiscal policy can protect inflation expectations from becoming deflationary expectations.