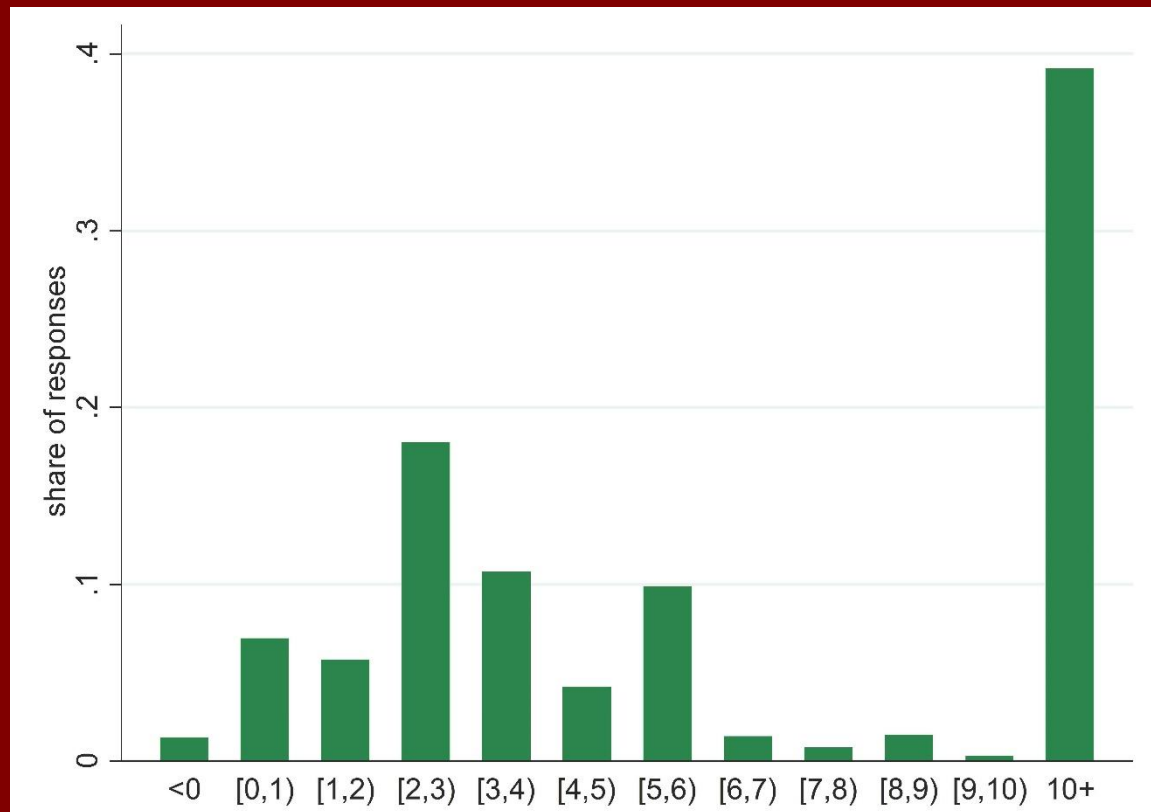# What's (not) up with inflation?

Michael Weber
University of Chicago

# Level of Informedness about Monetary Policy Goals

Source: Coibion, Gorodnichenko, Weber (2019)

Monetary Policy Communication and their Effects on Households' Inflation Expectations

❖ **Models used in Policy and academia assume individuals have full information and form expectations rationally**

❖ **We fielded survey on representative sample of 20,000 households**

❖ **Aim was to study level of informedness of US population about monetary policy goals**

❖ **40% of respondents thought the Federal Reserve targets inflation rates of more than 10% over longer periods of time**

❖ **One view: low level of knowledge possibly sign of success of Federal Reserve: ordinary people do not care about inflation in daily life**

❖ **BUT not innocuous in times of low interest rates when communication (only) game in town**

Sources of Information when Forming Expectations
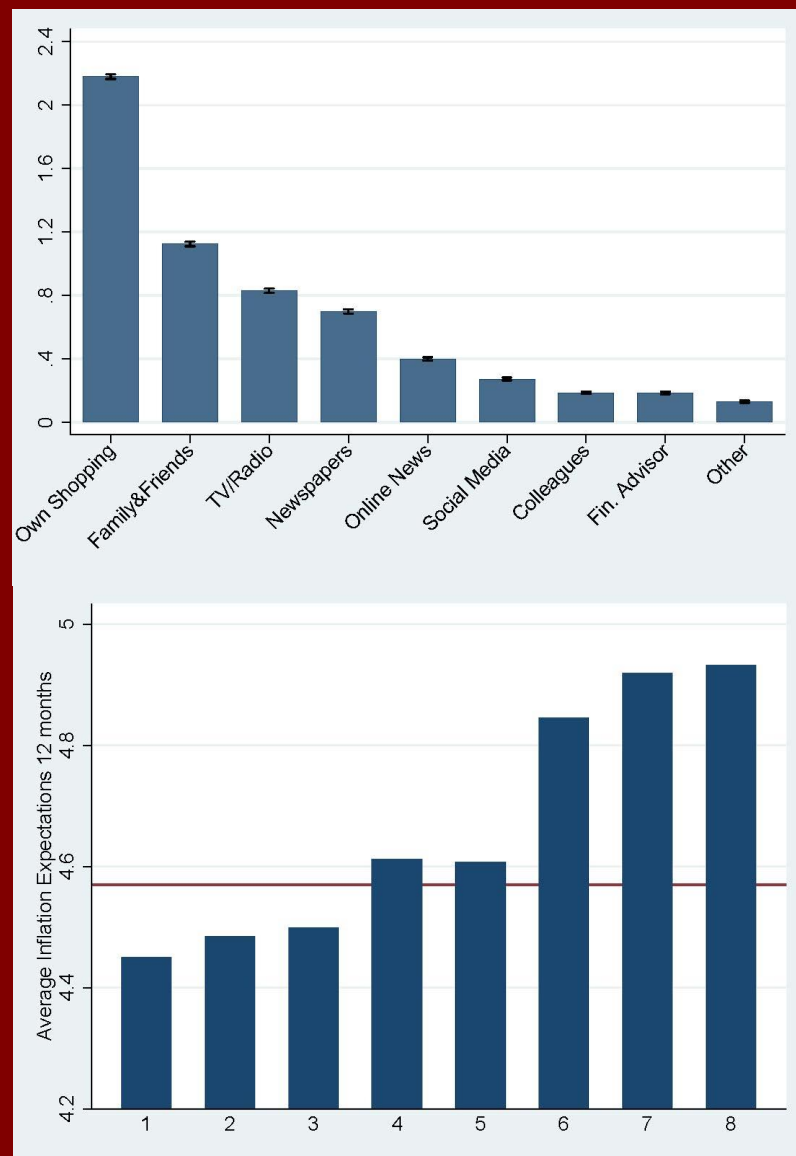
❖ **Representative sample of 50,000 households**

❖ **How do individuals form inflation expectations?**

❖ **Daily shopping experience most crucial**

❖ **Heterogeneity in past observed price changes in shopping bundle explains large differences in reported inflation expectations**

❖ **Goods purchased frequently matter more**

❖ **Focus on core inflation that excludes volatile price series such as groceries problematic**

❖ **Concerns for central bank credibility**

Source: D'Acunto, Malmendier, Weber (2019)
Exposure to Daily Price Changes and Inflation Expectations

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Heterogeneity in Inflation Expectations
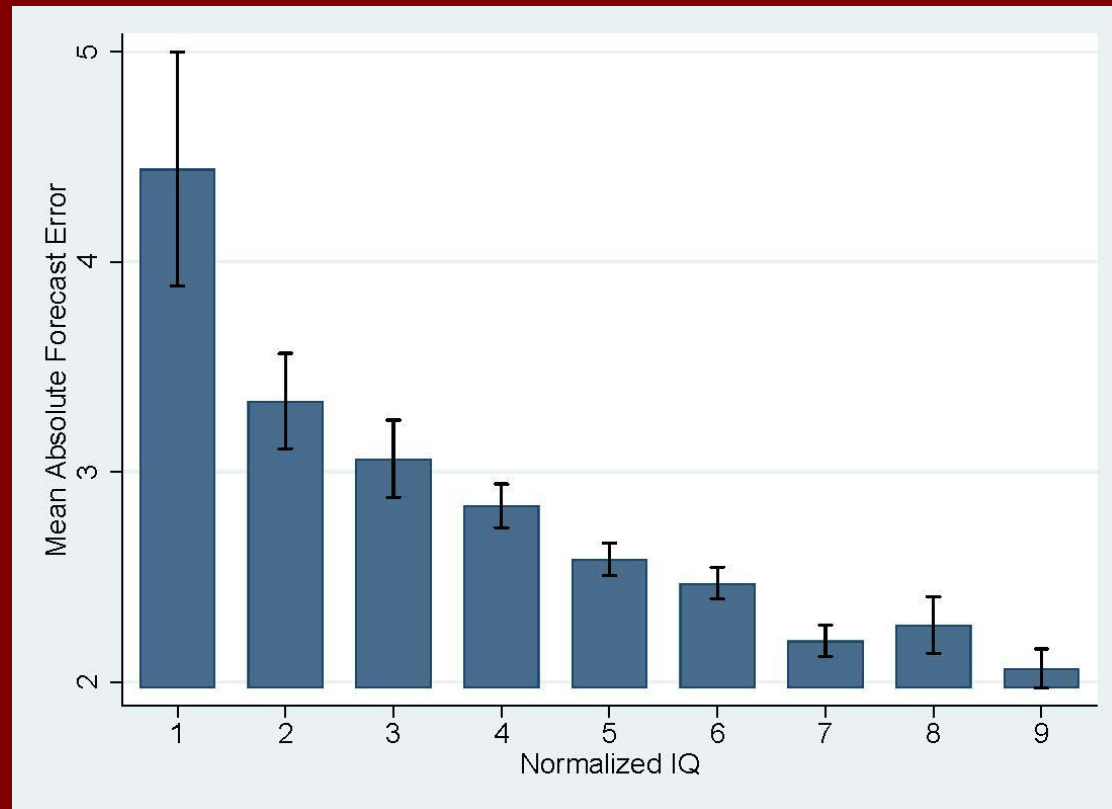
Source: D'Acunto, Hoang, Paloviita, Weber (2019)
IQ, Expectations, and Choice

❖ **How important limited cognition for effectiveness of fiscal and monetary policy?**

❖ **E.g., see Forward Guidance Puzzle**

❖ **Access IQ data for all men in Finland from military**

❖ **Link to European Commission Consumer Survey**

❖ **Study heterogeneity in forecast ability by IQ**

❖ **Mean absolute forecast errors more than twice as large for lowest IQ bins than for highest IQ bins**

❖ **Only men in high IQ bins adjust consumption plans to inflation expectations and propensity to take out loans to changes in rates**

❖ **Concern of redistribution in case policies not well communicated**

Simple versus Complex Policies
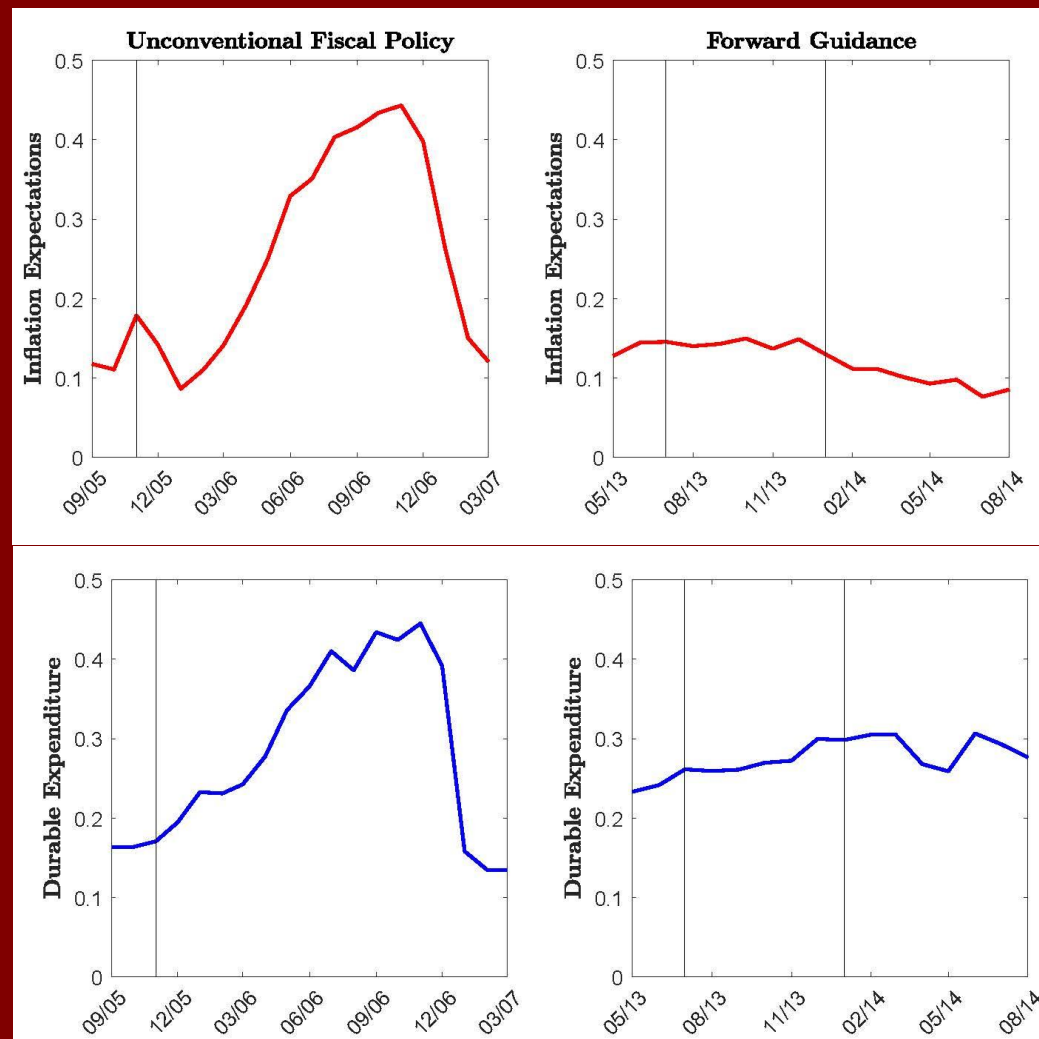
- ❖ **Unconventional Fiscal Policy** (= pre-announced increases in value-added taxes, VAT)

  → large increase in inflation expectations and durable purchases

- ❖ **Forward guidance** announcements by the ECB

  → no direct reaction by households

- ❖ Little evidence for indirect reaction to announcements

- ❖ All subpopulations reacted to announcement of future VAT announcements

- ❖ Simple policies successful in managing households' expectations and economic decisions

Source: D'Acunto, Hoang, Weber (2019)
Managing Households' Expectations with Simple Economic Policies

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Forecast Revisions to Policy Communication

Treatments	Immediate revision	
Population growth	$-0.224*$	$-0.271**$
Past inflation	$-1.170***$	$-1.241***$
Inflation Target	$-1.087***$	$-1.130***$
Fed inflation forecast	$-1.166***$	$-1.240***$
FOMC statement	$-1.284***$	$-1.298***$
USA today coverage	$-0.469***$	$-0.555***$
Unemployment	$-0.348***$	$-0.352***$
Gas Price	$1.490***$	$1.420***$
Controls for demographics	No	Yes
Nobs	19,654	17,979

Source: Coibion, Gorodnichenko, Weber (2019)

Monetary Policy Communication and their Effects on Households' Inflation Expectations

- ❖ **Randomized information to population groups**
- ❖ **Inflation expectations before and after**
- ❖ **Simple messages like current inflation**
  - → **large forecast revisions**
- ❖ **Size of effect dwarfs estimates of QE**
- ❖ **Traditional media discounted**
- ❖ **Individuals do not trust newspapers**
- ❖ **Effect of providing information transitory**
- ❖ **Direct, repeated, simple communication,**
  if central banks want to reach ordinary people

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