What’s (not) up with inflation?

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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.

Source: Coibion, Gorodnichenko, Weber (2019)
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

Exposure to Daily Price Changes and Inflation Expectations
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

Source: D’Acunto, Hoang, Paloviita, Weber (2019)
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
Forecast Revisions to Policy Communication

- 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

<table>
<thead>
<tr>
<th>Treatments</th>
<th>Immediate revision</th>
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<tbody>
<tr>
<td>Population growth</td>
<td>-0.224* -0.271 **</td>
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<tr>
<td>Past inflation</td>
<td>-1.170*** -1.241***</td>
</tr>
<tr>
<td>Inflation Target</td>
<td>-1.087*** -1.130***</td>
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<tr>
<td>Fed inflation forecast</td>
<td>-1.166*** -1.240***</td>
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<tr>
<td>FOMC statement</td>
<td>-1.284*** -1.298***</td>
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<tr>
<td>USA today coverage</td>
<td>-0.469*** -0.555***</td>
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<tr>
<td>Unemployment</td>
<td>-0.348*** -0.352***</td>
</tr>
<tr>
<td>Gas Price</td>
<td>1.490*** 1.420***</td>
</tr>
</tbody>
</table>

Controls for demographics

- No: 19,654
- Yes: 17,979

Source: Coibion, Gorodnichenko, Weber (2019)

Monetary Policy Communication and their Effects on Households’ Inflation Expectations