THE BROOKINGS PODCAST ON ECONOMIC ACTIVITY

“What do Americans think about inflation?”

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Episode Summary:

While many indicators suggest that the U.S. economy is thriving, Americans continue to have a negative overall economic outlook. Stubbornly high inflation has played a significant role in this negative sentiment among consumers, even as wage growth has caught up with the rate of inflation. In a new study, “Why do we dislike inflation?” Stefanie Stantcheva fielded a survey to explore how Americans experience inflation and why they have such strong feelings about it, identifying discrepancies between actual measures of inflation and perceptions as well as differences in understanding the drivers of inflation by demographics. In this episode of the Brookings Podcast on Economic Activity, Stantcheva discusses her findings with Economic Studies Vice President and Director Ben Harris.

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EBERLY: I am Jan Eberly, the James R and Helen D Russell Professor of finance at Northwestern University.

STEINSSON: And I'm Jón Steinsson, Chancellor's Professor of Economics at the University of California, Berkeley.

EBERLY: We're the coeditors of the *Brookings Papers on Economic Activity*, a semiannual academic conference and journal that pairs rigorous research and real time policy analysis to address the most urgent economic challenges of the day.

STEINSSON: And this is the *Brookings Podcast on Economic Activity*, where we share conversations with leading economists on the research they do and how it will affect economic policy.

EBERLY: Inflation has been top of mind for many in the last couple of years. The discussion on this episode focuses on just that: Americans' perceptions of inflation. Stefanie Stantcheva of Harvard University is the author of the new paper, "Why Do We Dislike Inflation?" And she'll be joined for a discussion by Brookings Vice President and Director of the Economic Studies program Ben Harris.

STEINSSON: I have to say that I was really struck by the strong response of the public to the bout of inflation we experienced over the past few years. People really hate inflation. Prior to COVID, there was an active policy debate about whether the Fed should raise its inflation target from 2% to perhaps 3 or 4%. The idea at the time was to give the economy a bit more of a buffer in downturns before it hit the zero lower bound on nominal interest rates.

But the recent experience really brings home that those benefits need to be weighed against the very real cost of having more inflation on average, which people dislike so much. Stantcheva's paper builds on a classic paper written in the 1990s by Robert Shiller, in which he surveyed the public and professional economists about their attitudes towards inflation.

EBERLY: That survey also showed that the public generally felt much more strongly about inflation than professional economists do. Economists may be underestimating how much inflation affects people and hence how much they dislike it. Stantcheva's paper provides a fresh look at this with a much richer data set on the preferences and beliefs of the public. The Federal Reserve is focused on bringing inflation down and remains committed to doing so. So, this understanding is very important not only to public policy discussions, but to the actions that are taken by the Fed and other policymakers.

STEINSSON: With that, let's hand it over to Ben.

HARRIS: Thanks, Jan, thanks, Jon. So, Stefanie, thank you so much for being with the Brookings Institution today, talking about your incredibly interesting paper, "Why Do We Dislike Inflation?" So, just to kick things off, let's start with the motivation for the paper, which builds on a piece by economist Robert Shiller from 1997. In terms of the motivation for both your paper and for his paper, why was the question of why we dislike inflation important then? Why is it important now? And how have things changed?

STANTCHEVA: Yes, that’s a really longstanding question. So, in a sense, I view this paper as just shedding new light on a really old question. And when Shiller asked this question 25 years ago, the economy was presumably quite different. Since then, we’ve had big changes: the COVID pandemic, geopolitical changes, a whole change in the way the economy works, technological changes. And so, it was kind of time to revisit this, especially in light of the recent inflationary episode, which is unusual in the last decades.

And so, our question was, with all these changes, have people’s views on the economy and inflation shifted significantly or not?

HARRIS: So, your paper asks a straightforward question, but one with a complicated answer: why do people dislike inflation? So, you conducted two surveys, one closed and one open ended, to try to get answers directly from people. So, at a high level, at a summary level, what did people say?

STANTCHEVA: Yeah. So, the way to revisit this a little bit is really with the new survey methods that we’ve developed since the original Shiller paper. And you’re right to mention that part of the survey is actually with very open-ended questions, so that we really hear what people have to say, what comes to their mind without priming them one way or the other. And this is complemented by much more structured questions. And contrary to in the ‘90s, this is done on a much larger sample. So, we can also look at the effects on different demographic groups, including by income, political orientation, age, etcetera.

And to summarize the findings, perhaps, you know, super briefly, inflation is definitely not considered just a yardstick by people. So, it’s by far not just a measurement. And if we have to give just one single reason for why people dislike inflation, it’s simply that they believe their wages do not keep up with prices, and so their living standards are declining.

And this perception is really amplified by the belief that when people get wage raises during inflationary periods, as does happen, it’s quite rare that people do attribute them to adjustments for inflation. They’re much more likely to attribute them to job performance or progression, career progression. And this is especially true if you switched jobs during that period.

And then people also have very clear beliefs about why wages are lagging behind prices. So, they tend to believe that employers have substantial discretion rather than being subject to market forces. So, in a sense, the predominant belief is that if your employer is not raising wages, it’s because they choose not to do so to keep their profits high.

So, that’s a little bit of everything that goes into why people dislike it as a main reason. But it’s related to other things. For instance, that people tend to perceive inflation will have quite unequal impacts. And you see this in two ways. One is that overall, low-income respondents report being much more affected by it along many margins. And second, there’s also a very clear perception that the wages of higher income people grow faster than others and are better able to keep pace with inflation. So, all that contributes to a big sense of inequity.

And it also goes hand in hand with very negative emotions triggered by inflation. If you ask people to just express what they feel when they see prices rise, anger, negative emotions, stress come up a lot. And so, all these are basically the reasons why people dislike inflation.

HARRIS: One of the things I thought was really interesting about your study was that you tested both people's ability to understand inflation conceptually, like, you asked them, do you technically understand what inflation is? But you also tested whether they could report the actual rate of inflation experienced in the U.S. economy. So, let's start with the conceptual answer first. You tested people's ability to understand what was inflation. What do you find?

STANTCHEVA: Yeah. So, I do this in two ways actually. If you just ask in very stylized examples, prices today are this, prices today in a year are at this other level, what is inflation? just to compute that, most people are able to do this correctly in a very, very stylized example.

But if you ask people open ended early to define inflation, answers are split between relatively correct answers and relatively incorrect answers. Some of the incorrect ones, which I think shed a lot of light on the underlying feelings and emotions about this, are things like, and I'm quoting here directly from survey answers, inflation, to me is where the cost of living rises above affordable means for the majority of people. Or some people say it's overpriced everything, not being able to afford to live. Price gouging, especially by the greedy by raising prices so high so that everything is too expensive. So, you can see even in the definition that people will give of inflation, the underlying sentiment.

Then if you ask people to estimate what inflation has been over the last 12 months and to predict what it will be, what we see is that the median perception of what has happened is around 5%, when the reality by the time the survey was done was 3.4%. So, there's an overestimation by the median respondent, but the mean is actually much more skewed. It's around 7%. So, in that sense, the mean person really overestimates what inflation has been in the past.

Then people tend to extrapolate from what has happened to the future. So, the expected inflation is very much in line with the perceived inflation over the last 12 months, only slightly lower. And you can see big differences across groups too. So, higher income respondents both perceive inflation to have been lower and expect lower inflation over the next year. And then groups that think inflation has been higher and have higher inflation expectations are Republican respondents, female respondents, and Black respondents.

So, there's clear differences across groups and how they have actually perceived the last year in terms of inflation and accordingly the expectations they have for the coming year.

HARRIS: So, Stefanie, looking at the details of your paper, you identified some pretty striking patterns in the way different demographics perceive inflation and its drivers. So, for one example from your paper, 24% of Republican respondents thought the Biden administration was the main cause of inflation, but only about half of that percentage for Democrats saw it that way. Can you talk a little bit about the role of politics in shaping people's perceptions about inflation?

STANTCHEVA: Yes, you're right to mention that there are some pretty big partisan gaps in the perceived causes. And in some follow up work I'm doing right now, you also see these gaps in the perceived consequences from inflation, and also in terms of who people think actually loses and wins from inflation. So, there are partisan gaps somewhat on the whole chain of reasoning if you want.

And it's hard to know where that comes from, whether it's from the media that people consume or just from many other influences they have. But it is very much in line with other work, including by me and coauthors, where we coined this term, which is the "polarization of reality," which says that even on things that are in some sense perhaps more objective, and the causes of inflation are not that clear cut and objective, but even on other variables where things are much more objective, there are large partisan gaps, including on things like the perceived current top tax rate, which is a number you can just Google. And so, it is very much in line with this polarization that is quite large even on reality.

HARRIS: And so, do you have any insight into how changes in the way people receive their information, maybe since that 1997 Shiller paper, might influence changes in perceptions around inflation? One hypothesis could be is that the increased influence of social media, potentially at the expense of more traditional types of media, may have influenced people's perceptions about inflation. Do you find any evidence in that in either your study or in the literature that's developed over the past quarter century?

STANTCHEVA: I think these are all very plausible hypotheses. I don't have a direct proof for that, but what I can tell you is where people get their information from. So, I ask people specifically what's their main source of information among formal sources. And among formal sources it's television, followed by newspapers very closely with social media.

But overall, the main source of information is none of these. People tend to say the biggest information for them comes from their recent purchases. So, basically, the prices that they see when they go to the store or they make purchases. And so, in the end, less than 15% seem to rely on official statistics or news, but rather use their own experience as a guide to what they think about inflation.

HARRIS: Throughout your paper, you discussed how different parts of people's lives might be impacted by inflation differently. So, you have this approach where you differentiated between how inflation can impact consumers differently or how people view inflation as a worker, or how people regard inflation as an asset holder. Can you discuss for the audience why this distinction between workers, consumers, and asset holders is important?

STANTCHEVA: Yes. So, we as citizens, as people all have different roles. And inflation is one of those phenomena that can really affect us in many different shapes and forms. So, as consumers, obviously the prices of the goods and services we buy will be affected. So, that is one way in which it affects us. But our jobs are potentially affected too. Whether it's the extent to which our wages grow or don't grow, the extent to which the industry is doing better or worse because of inflation, etcetera.

And then people have very different asset positions when the amount of debt that they have, the amount of cash that they hold versus the amount of financial assets. And so, all of this will mean that people will actually face quite different impacts. So, looking just at what you consume is not enough to tell what will be the impacts of inflation on your life.

And so, I think it's really important to take that more comprehensive and holistic view. And indeed you see that people believe there are quite different impacts in all these areas of their life. When I asked them in detail how they have been impacted, but also how they have reacted to these changes, we can see that the most important ones that people perceive are definitely impacts as consumers. And this is basically where people say that they would have to reduce both the quantity and the quality of goods they buy. And this is especially pronounced among lower income respondents. But it is also there to some extent among higher income ones.

And then as workers, people also do feel impacted. But to a lesser extent. The main impact is that they feel like their wage is just not keeping up. And that's pretty commonly spread. And as I mentioned, they do feel like the wages of higher income people are much more able to keep up with inflation. And again, even as workers, it's lower income people who feel more impacted.

As asset holders, again, people have such different positions. People who have more savings in cash feel like those savings are devaluing. People who have more debt actually feel that it gets harder to pay their debt, even though, you know, in nominal values, normally debt should be devalued. So, there's all these different impacts which are typically more pronounced among lower income respondents.

HARRIS: So, two quick follow up questions on that. I mean, you brought the role of debt. And if you're a holder of a 30-year fixed-rate mortgage, all else equal high levels of inflation should be good news. If your wages rise at similar levels. And so, why hasn't this been a bigger part of this story, that holders of debt might be making out relatively better during this higher bout with inflation?

STANTCHEVA: That's actually something that other research has taken up, too, which is to show that people tend to not really perceive debt, if you want, debt devaluation channel. So, it could be the combination of not feeling that your income is keeping up. And so, overall, people tend to report that they're having a harder time paying their mortgage or paying their debt. While you're absolutely right in real terms, that debt does get devalued if you have a fixed rate mortgage.

People do understand that those who have a flexible rate mortgage are more affected than others, but generally there's that feeling that inflation just makes things harder, including paying your debt.

HARRIS: And so, you brought up the perception by lower income households that this bout was harder for them than higher income households. The comparison between nominal wage gains and inflation, and across the wage distribution, can depend on a lot of factors: which measure inflation you're using, which measure of wages you're using, what time period you're using.

But my reading of the experience over the past several years has been that this has been relatively good news for workers at the lower part of the wage distribution. That is to say, that real wages have risen faster for those in the bottom 40% or so of the wage distribution than for those at the top of that.

So, A, I mean, do you agree with that characterization? And B, if you do agree with that characterization, why isn't that story coming through?

STANTCHEVA: That's really a question that I've been asking myself over and over, and I think there's a few things to say on this. The first is that I would be very hard pressed to say someone is wrong unless I'm super, super sure that I have the right answer. And in this case, I think we're actually not really great at measuring the true inflation people are experiencing.

And I think there's a lot of really great work in maybe in the last 5 to 10 years that's emphasizing this idea of inflation inequality, which is the baskets of goods and services that people in different points of the income distribution consume can be extremely different and actually affected very differently by inflation. A lot of that work tends to say the impacts are quite regressive, so that the baskets of goods are actually becoming more expensive at a faster rate for lower income people.

So, that is perhaps one part of the thing that we're actually really mismeasuring when we use, let's say, just the CPI, which is an average index, and compare that to the nominal wage rises. So, I wouldn't be surprised if we're really missing part of the story.

But another thing that we're perhaps missing is simply that there are some true, it seems, psychological and emotional costs from inflation, whether it is because people feel like they're getting poorer or because it does require them to rethink their decisions, re-budget, potentially look for other jobs to get pay raises, will have to rethink things that they're currently buying and switch, etcetera. So, there seems to be some real cognitive emotional costs here that are real.

And you know, of course, a final hypothesis could be that inflation is just something that is creating negative sentiment about the economy. And so, it is just making people more pessimistic about the future. We do see that in the data.

But I'm not sure that's the whole story. And so, I wouldn't say we have perfect measurements, and we can 100% say these are the right numbers and these are what perception gaps are here. I think there's so much more work for us to do on the actual measurement of what's experienced.

HARRIS: I'm glad you brought up sentiment. That's something that we've been exploring here at the Brookings Institution. And it was certainly something that I spent a fair amount of time at when I was assistant treasury secretary until about a year ago. But I think there's a bit of a puzzle here. And the puzzle is not that people are upset by inflation because, as you have noted, as a consumer, this has real costs.

But one thing that's been a bit of a puzzle, for me at least, is, why has inflation seemed to drown out other aspects of the economy which feel like they're good news? Why has inflation drowned out, for example, this ultra-low unemployment rate that we've had, why has inflation drowned out this wealth boom that we've experienced? Why has inflation drowned out relatively low levels of household financial stress, particularly low rates of foreclosures? And I could go on and on and start listing other positive aspects of the economy.

One hypothesis around the sentiment puzzle is just that when you see elevated rates and inflation, nothing else matters. And so, my first question to you is, do you think there is something to that hypothesis? That once we get out of historical norms for inflation, perhaps once we get above 4% or so over a year-over-year basis, that all the good news just gets drowned out by this atypical spike in inflation. Do you think there's something to that?

STANTCHEVA: Yeah. So, I want to caveat this with the answer to the previous question, which is I'm not sure we're measuring this perfectly. So, as we discussed previously, it might be that for a lot of people are actually underestimating the true impact this actually has.

But I do think this idea of sentiment is quite relevant because there's some really asymmetric effects here for many of the things you mentioned. For instance, unemployment. There's a minority of people who are unemployed, and for them the benefits from finding a job are gigantic, so those gains are super concentrated. But the losses as consumers from inflation are potentially felt by many, many people.

And so, I see this also if I carefully ask people to really choose between different scenarios with higher inflation and lower unemployment. If you do this in a really careful way, you see that people put more weight on inflation. And I think that the reason is simply that everybody feels the losses from inflation, but unless you yourself are unemployed, you might feel less the bite of more unemployment or a little bit less unemployment. And so, I think that that plays a role in this negative sentiment.

And it's clear that people associate inflation with a bad economy. There's no such sense that inflation might go hand in hand with high demand or high growth. Not at all. Among the vast, vast majority of people, inflation is simply a sign of a bad economy. It's associated in their mind with bad political, social costs, economic costs. So, it's an unambiguous bad.

HARRIS: And I think that you see that when you look at surveys of Americans asking them not to report on their own financial circumstances but asking how accurately they're describing the macroeconomic outlook. You've seen in some surveys, some fairly inaccurate overall response rates, where one example I've given in some essays written for Brookings was a 2020 Morning Consult poll that showed that roughly half of Americans described the U.S. economy as in recession in 2022. And of course, it was not. And so, I think that that probably lends some credence to what you just said, which is that people associate higher rates of inflation with other negative economic outcomes.

Can I ask you about another puzzle along the lines of consumer sentiment and inflation? One thing that I find a bit vexing has been, if you look at the Michigan Index of Consumer Sentiment by age, and you look at response rates by people who are older than 55, coming into the pandemic consumer sentiment across ages was fairly consistent. But consumer sentiment over the next three years or so for people aged 55 and older dropped more rapidly than for their younger counterparts. I would have predicted the opposite. So, I would have thought that older households who had inflation-indexed Social Security, who had implicitly indexed Medicare, who perhaps were beneficiaries of the wealth boom, would have been relatively more sanguine about inflation than younger households. But we saw the exact opposite.

Do you have any idea why older households reacted differently to inflation than younger households?

STANTCHEVA: That's an excellent question. So, the first thing to note, and I completely agree, the sentiment has been much more steeply dropping among older households. But many people above 55 are still very much working and their incomes are not necessarily indexed by any means. But that aside, it is absolutely true that the sentiment is dropping. And in fact, if you branch out from people's own experience and ask, as I do in this new project, about what are their perceived consequences on the economy, on other people, the causes of inflation, etcetera, you can see that older households just very systematically view inflation as much worse than younger households. They expect much worse consequences on the economy overall, on everybody else. So, there's a clear, much bigger fear of inflation among older households.

And to some extent, it might be that older households have accumulated more net positive assets and they feel like those are getting devalued. But I think the biggest explanation is one based on experience. There's really interesting work showing people who have experienced periods of inflation in their past are much more likely to have a negative view of inflation and to dislike it more. And age is somewhat correlated with having experienced other episodes of inflation.

It's particularly pronounced in some countries, like the Eastern European countries previously also in Germany, like countries that have memories of high inflation, it's very clear that the older generations have a big experience with that, and I think that could be driving it.

HARRIS: Shifting now to lessons for policymakers. Are there any key ideas you think policymakers, whether they're in the administrative branch or potentially at the Federal Reserve, should take away from your research?

STANTCHEVA: That's a great question. In general, I'm really a big proponent of better economics education. That does go beyond this project. It's simply because, as I notice in a lot of my work, there are things which affect people's daily lives in such important ways, like lots of economic policies that people are asked to take a stand on, to vote on, to express views on where there would be such a benefit from a little bit of more economic education. We get educated in so many different fields, and economics is actually something that does affect people's lives in really substantial ways. So, that is more of a general lesson that I keep taking away from lots of projects.

But learning really goes both ways. So, I think through this whole survey work, to really dive into people's minds and understand how they think, we are learning a lot, and in particular we're learning about constraints and concerns people have that we might not have been aware of.

And in this case, I think there's a big lesson here that our measurement is perhaps off. And we want to improve the measurement of how people are actually experiencing inflation. I'm really glad to see all this work about inflation inequality and how it impacts people in different places at different points in the income distribution differently, because I do think that is critical.

And beyond that, regardless of what we feel in terms of the hard economic impact, I think it's very important to take seriously into account that inflation is causing emotional and stress costs and cognitive costs for people. I think those should be taken very seriously given how people are expressing them. So, I think that's another lesson to take away from this.

HARRIS: One thing that I thought was interesting during the Biden administration was how much Ron Klain, when he was chief of staff, focused on gas prices. And so, he was a very active poster on social media about changes in retail gas prices. Do you find that certain prices matter more than others? So, the conventional wisdom in my discussions with people around inflation was that gas prices, perhaps because of their saliency, matter more than other types of prices. Did you find this to be true? That perhaps gas prices and food prices matter more than other types of prices?

STANTCHEVA: Yes, definitely. And actually, food ranks highest by quite a bit. And then it's followed by gas prices. So, that's absolutely true. And it's ahead of things like utilities or rent payments. But yes food and gas come up all the time. So, that is something that is clearly there. And it makes sense given what the share of the budget of many households this is.

HARRIS: So, you're attributing the outsized weight to the fact that people spend a large share of their income on these, not necessarily on their salience. So, rent is also, for example, a big share of people's expenditures. But it seems like the conventional wisdom is that perhaps rent or clothing or other items matter less than retail gas and matter less than food. But it seems like your impression is that it's just related to the size of the consumption basket, not necessarily to the salience. Is that an accurate way of putting it or am I misrepresenting your view?

STANTCHEVA: No, no. Food and gas are a big share, but rent is also a very big share. But somehow the perception is very much that food and gas are just growing at a much more rapid pace than rent for the average respondent. And that's true for many, many respondents.

HARRIS: So, let's say that inflation follows the Federal Reserve's projections and that we see inflation over the next year or two begin to moderate and get closer to the Federal Reserve's 2% target. How long do you think it will take people to move past the most recent bout with inflation? And at what point do you think that this psychological stress that you've emphasized several times will begin to dissipate? Do you have any idea how long the scars of inflation will continue to persist?

STANTCHEVA: That’s a really hard question. There’s all these psychological effects. Some of them might be short lived, but as I mentioned before, there’s also a big literature showing that your lifetime experiences matter, and people who have lived through inflationary episodes somehow have different attitudes and even investment behaviors and risk behaviors later on that are quite persistent. So, there’s a chance that those psychological effects could really persist.

And then beyond that, you know, if there’s true actions people take like changing jobs or switching to a different job, those could also have quite persistent effects. So, it’s really hard to say, but there’s potential channels through which this could have quite long-lasting effects.

HARRIS: Stefanie, thank you so much for being part of this podcast. Thank you for your incredibly relevant and high-quality research.

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BPEA was very lucky to have you and so thank you again. This was just a fascinating conversation, and I was glad for the chance for the talk.

STANTCHEVA: Thank you so much, Ben.

STEINSSON: Once again, I’m Jón Steinsson.

EBERLY: And I’m Jan Eberly.

STEINSSON: And this has been the *Brookings Podcast on Economic Activity*. Thank you to our guests for this great conversation and be sure to subscribe to get notifications about new releases of this podcast.

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