Inflation Expectations and Consumption Decisions

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Main idea

General

Do expectations matter for consumption?

- policy-relevant question: if we can affect expectations (e.g. through monetary policy announcements) - does this affect aggregate demand?
- in general terms studies the link between *beliefs* and *decisions*

Main idea

Survey

Survey adminstration

- individual data from the French household monthly consumer confidence survey
- 2,000 interviews via phone calls
  - Every household surveyed during three consecutive months.
  - 1,100 new calls every month.
  - total 150,000; most three times, 24% surveyed twice and 16% once.

Inflation expectations

- two inflation expectation questions:
  - Qualitative: prices increase more rapidly - same rate - slower rate - Stay about the same - Fall - Don't Know
  - quantitative: Consumer prices will increase/decrease by XX.X%
  - RESTRICTION: "stay about the same" (qualitative) implies 0% inflation (quantitative)
- same for perceptions of inflation

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Main idea

Survey

Consumption

- consumption = durables
- both past (last 12 months) and future (next 12 months)
- both personal decisions and general perspective
  - personal durable spending over the last 12 months.
  - "Do you think it is the right time for people to make major purchases"?
  - "Over the next 12 months will you make major purchases"?
  - "Over the next 12 months, will you buy a car?"?

Results

In brief

Consumption (main result)

- higher expectation $\rightarrow$ higher reported intention to make major purchases in the next 12 months
  - only for moderate levels of expected inflation - both qualitative and quantitative
  - pronounced in the 1st interview sample
  - vanishes for quants in 2nd interview but re-appears in the 3rd
  - weaker for quals in the 2nd and vanishes in the 3rd.
- authors conclude effect mostly driven by extensive margin (those who switch from "no inflation" to "some inflation".

Inflation expectations

- heterogeneous though many expect stable prices;
- upward bias (thought not that much)
- adjustment in the average inflation expectation mainly through extensive margin (change in the share of households expecting no inflation)
- little change in the average expectation of households reporting positive inflation (the intensive margin)

Discussion

Empirical questions

- why pool 14 years of interviews in one cross section?
- why impute zero inflation rate from "prices stay the same"?
  - "stable prices" is a matter of definition/sensitivity to "change" - which ranges of inflation were truncated to zero?
  - collapsing may induce insensitivity of consumption to quantitative measure (you remove all low observations) - what is the quantitative relationship among those truncated?
  - different sensitivity to high/low inflation may be captured by non-linearity - why is truncation better?
- education/motivation effect of surveys?
  - do respondents better understand questions/subject matter in subsequent surveys? are they better informed? what drives attrition/retention?
  - intrinsic motivation drops the more we ask respondents → selection bias in 2nd and 3rd rounds (e.g. Vinogradov and Shadrina, 2013).
  - control for "consumer took part in the survey before" or "new consumer" - instead of three subsamples?

Discussion

Theoretical questions

- why should *inflation expectations* affect consumption?
  - typically *real interest rate*
  - discussion in introduction and in Euler equation but then abstract away
  - any implicit assumptions on interest rate (perception)? any justification?
- should r or π affect *current* or *future* consumption?
  - intertemporal consumption choice (Euler equation) is about *the whole* consumption path and *continuous* choices
  - decision to buy (from the initial point of no buy) is a *change* - response to a *change* in expectations
  - *change* in expectations may have taken place earlier $\rightarrow$ consumption already respnded, or HH report reflects change $\rightarrow$ consumption will respond.
- what about uncertainty?
  - Bertola, Guiso and Pistaferri (2005, ReeStud) - income uncertainty $\Rightarrow$ "inaction" in a very uncertain environment
  - uncertainty about future inflation?
  - may lead to differential effects in periods of high and low uncertainty (sample covers pre-, in- and post-crisis periods)

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Discussion

Nominal interest rates

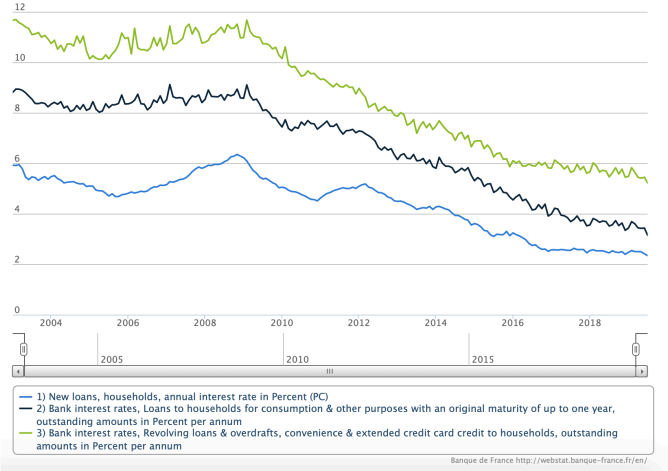

Figure: Nominal consumer interest rates in France 01/2003 - 07/2019

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Further remarks

- unusual approach to define inattentive (to inflation) consumers:
  - responses that are multiples of 5. Why?
  - alternative approach = answered at least once perceived inflation close to actual
  - difference between attentive and inattentive lacks significance
  - multiples of 5 occur rather as rounding up or down when subjects are uncertain wrt what to answer, perhaps a measure of uncertainty?
  - hence "rounded" answers are less likely to move than unrounded, hence potential difference in effects
  - maybe instead use sociodemohraphics to predict likelihood of following economic policy news (see Carola Binder's research)?
- question on savings ("good/bad time to save now" and "will be saving less/more in the next 12 months") can give additional insight on general consumption decisions (not only durables).

Conclusions

- relatively long data on inflation expectations, past/future personal consumption and general consumption climate
- characterization of heterogeneity in expectations
- characterization of impact of expectations on consumption
- expectations matter even if not part of real interest rate! $\rightarrow$ policy implications
- I have learnt something new but I want to learn more