

Inflation Expectations and Behavior: Do Survey Respondents Act on their Beliefs?

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Discussion by
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1. Summary of paper

Research questions:

- 1 Do individual consumers act on their beliefs about future inflation?
 - 2 How informative are the inflation expectations elicited with surveys about the respondents' true beliefs?
 - focus on **individual consumers** rather than other agents (e.g. professional forecasters, financial market experts)
 - use of **direct measurement** of inflation expectations (via survey questions) & financially incentivized investment **experiment**
- ↓
- investment A whose outcome depends on rate of inflation
 - investment B whose outcome does not depend on rate of inflation

1. Summary of the paper

Objects:

- Price of things I usually spend money on
- Rate of inflation

Time horizons:

- From now and 12 months from now
- Btw 24 and 36 months from now

Measures:

- Point predictions
- Probabilistic beliefs → “Estimated expected prediction” and “Estimated std.dev. of prediction”

1. Summary of the paper

Treatments:

- Survey treatment
 - Price in general
 - Rate of inflation
- Experimental treatment
 - Ascending scale earnings
 - Descending scale earnings

Models:

- Switching point btw investment A and B → Research question 1
- Minimum distance from risk neutrality → Research question 2

2. Main findings

Switching point analysis:

- No **treatment** effect
- Consistent with theory, there is a generally monotonic decreasing relationship between the reported price/inflation beliefs and the switching point
- Strong relationship between a respondent's price/inflation point prediction and his/her switching point
- All else equal, more **risk** averse subjects have lower switching point, while more risk loving subjects have higher switching point
- Respondents with more **diffuse beliefs** tend to switch investment earlier
- Neither the measure of **numeracy and financial literacy**, nor the **time taken by respondents to complete the survey** seems to have explanatory power

⇒ Evidence of *relationship btw stated beliefs and actions*, on average

2. Main findings

Min. distance from risk neutrality analysis:

- Strong positive relationship between the **self reported distance from risk neutrality** and the distance from the risk neutral choice
- Inconsistent with theory, additional parameters are significantly different from zero
- Both the measure of **numeracy and financial literacy**, and the **time taken by respondents to complete the survey** seems to have explanatory power

⇒ Evidence of high degree of *heterogeneity* across individuals, explained by *risk aversion and optimization errors*

3. Comments

Subjective SAS risk aversion and Table 4 results

- 1 to 7 scale - from very risk averse to very risk loving - 4 = risk neutrality
- but.. is 4 really risk neutrality or a proxy for “I do not really know?”
- do you give the possibility of Do not know answers?
- what about focal points?
- worth trying defining risk neutral those reporting answers 3 & 5 and dropping answer 4?
- alternative measures of risk aversion? more objective? e.g. share of risky assets in their portfolio?

3. Comments

Heterogeneity across individuals

- In line with Ehrmann et al. (2010): disagreement among professional forecasters
- Away from the “representative agent” model
 - What are the consequences for a CB?
 - Is this a good/bad thing?
 - Can this potentially lessen the ability of CB to manage inflation expectations?

Price in general vs Rate of inflation

- How do the two measures correlate with each other?
- Ex-post: can you say whether one is better perceived than the other?

3. Comments

Very relevant topic!

Monetary policy

- Svensson (2004): *Monetary policy is to a large extent the management of expectations*
- Woodford (2003): *Not only do expectations about policy matter, but, at least under current conditions, very little else matters*
- Bini Smaghi (2005): *Inflation is the “Enemy n. 1” of central bankers*

CB communication

- Bernake (2005): *A more transparent policy process increases democratic accountability, ..., reduces uncertainty in financial markets, and helps to anchor the public's expectations of long-run inflations, which promotes economic growth and stability*
- Ullrich (2008), “Inflation expectations of experts and ECB communication” in *The North American Journal of Economics and Finance* - the indicator measuring the informational content of ECB rethoric contributes to the explanation of inflation expectations formation of financial market experts
- Can your paper (or potential extensions of it) contribute to this literature?