Inflation Expectations and Consumer Expenditure

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Household Economics and Decision Making
Federal Reserve Bank of Cleveland

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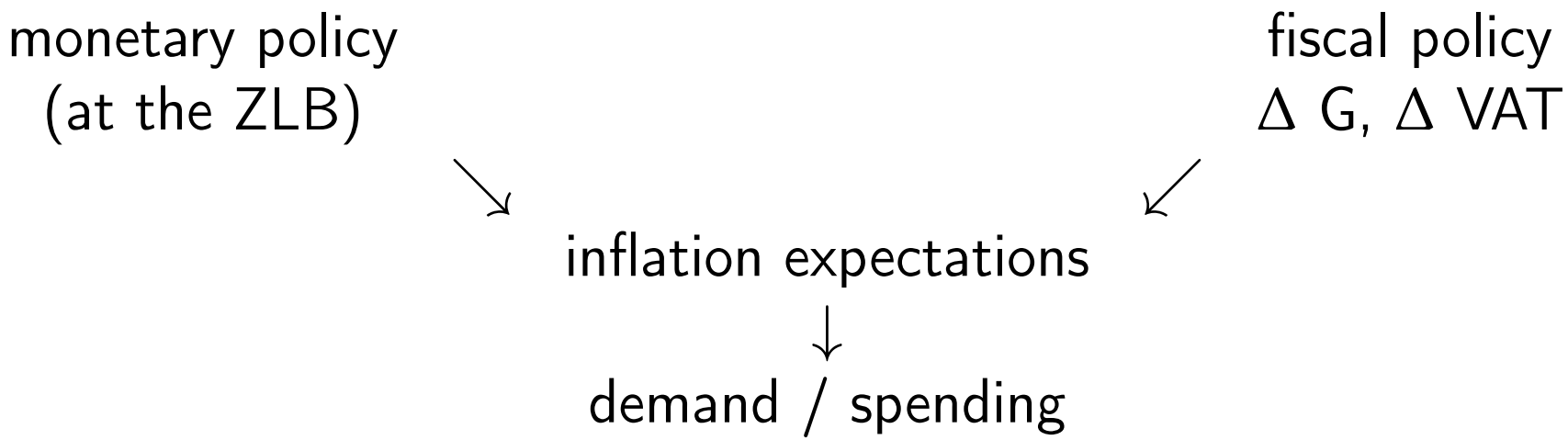
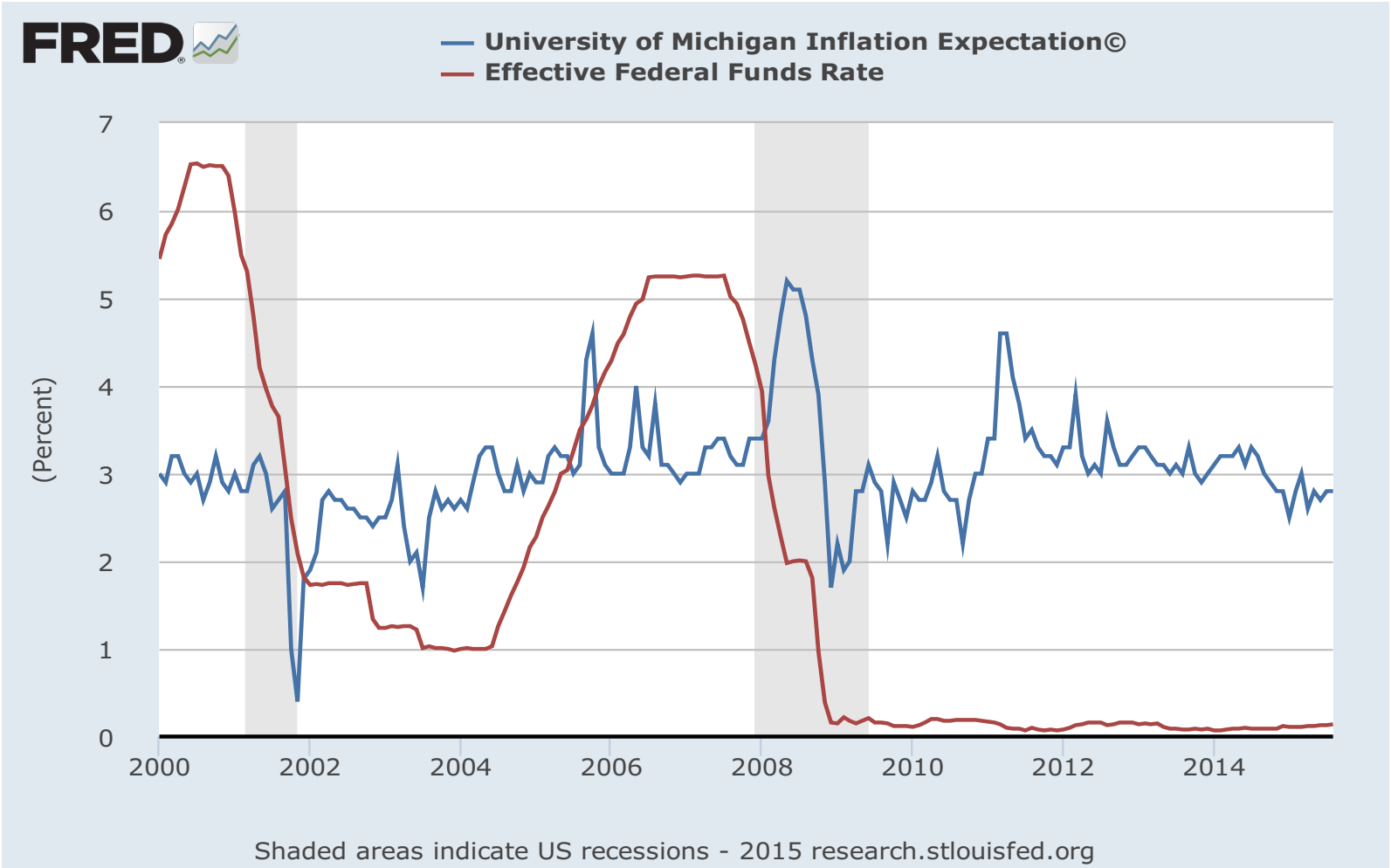
Stabilization Policy and Transmission

In the Neokeynesian model:



Monetary Policy and Inflation (Expectations) - Hall's Presidential Address



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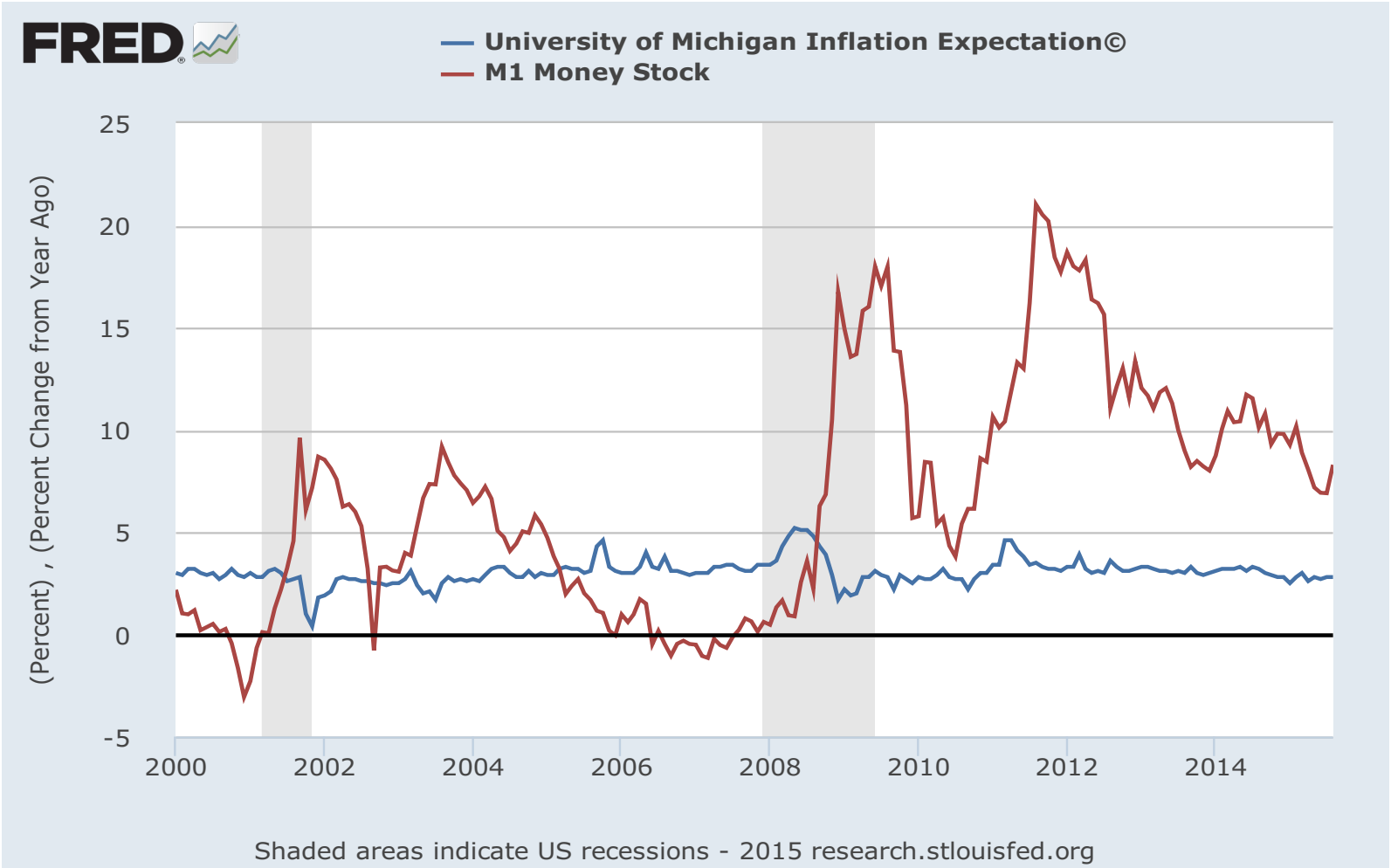

Fiscal Policy and Inflation (Expectations)

Dupor and Li (2015): use 2009 Recovery Act to show that the channel from ΔG to inflation is pretty much clogged up.

Inflation (Expectations) and Demand

- Real interest rate (Neokeynesian model), especially at constant (zero) nominal interest rates
- Real debt redistribution
- Inflation tax
- Economic policy trust / confidence / uncertainty

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  - Panel dimension: for "good" inflation forecasters, we get a significantly positive sign.
  - Households understand relative prices: expected house price increases lead to a higher readiness to buy a house now.

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  - Ichiue and Nishiguchi (2015): Japanese households have a positive sign (long life under a ZLB regime?)

Part I

Same as the three other papers.

- On German data.
- With no panel dimension.
- Qualitative inflation (change) expectations only.
- Putatively better measure of individual readiness to spend?

Comment I

- I would not dismiss quantitative inflation expectations so readily.
- If people have crazy inflation expectations and act on it - so what?
- One can always play around with the outlier criterion and retain an intensive margin effect within the "reasonable" band.
- Binder (2015) is not an argument for the superiority of qualitative inflation expectations, just that they might be coarser than a continuum.

Comment II

- German survey (in translation): Given the current economic situation, do you think it's a good time to buy larger items such as furniture, electronic items, etc.?
- Michigan survey: About the big things people buy for their homes – such as furniture, a refrigerator, stove, television, and things like that. Generally speaking, do you think now is a good or a bad time for people to buy major household items?

I don't see the big difference here.

- The German survey (not even in the original) does not refer to a *household's* economic situation; in fact, it says: general (*allgemeine*) economic situation.
- The German survey does not ask whether it is a good time *for the household* to buy stuff.
- Conversely, we know that the answers to the Michigan survey correlate much more strongly with other questions about idiosyncratic rather than aggregate stuff.

Part II

- Use the VAT increase announcement in late 2005 for 2007 as a natural experiment to get much better at causality.
- Diff-and-diff with other European countries.

Results

- VAT increases raise inflation (expectations).
- Inflation expectation increases increase the readiness to spend on durables significantly and robustly.
- Especially for more educated, high-income urban households.
- Inflation expectation increases increase the readiness *not* to spend on durables. Robust?

Comment I - Regression Part - Specification

- The dummy is really not on high inflation, but on high *changes of inflation*, i.e., a second-order concept.
- Not sure what the theory says on inflation acceleration.
- For the VAT experiment: at the beginning of 2006 CPI inflation seemed to have reached a local minimum, everyone expects a quick return to normal and is thus happy to buy?
- This is especially worrisome as past inflation expectations come out negatively.
- After all, inflation expectations are highly persistent.

Comment I - Regression Part - Specification

- The appendix puts individual dummies on higher inflation, same inflation, lower, but positive inflation. The result is really driven – quantitatively – by higher inflation.
- Suggestion: create one dummy that is 1 for: higher inflation, same inflation, lower, but positive inflation and report the results with and without past inflation perceptions.

Comment II - Regression Part - Specification

- I am not sure that it is correct to call the "puzzling" positive result from inflation expectations to bad times for durables non-robust, because it vanishes when some other expectations are controlled for.
- No, this tells you something about the transmission mechanism.
- What if there is a policy-trust channel that you control away with these other expectations?

Comment III - VAT - "Same trend"-assumption

- Is it really sufficient to show that the countries were on the same trend for inflation and durables?
- What if Germany just was in a state of heightened confidence / good economic outlook after the Hartz reforms?

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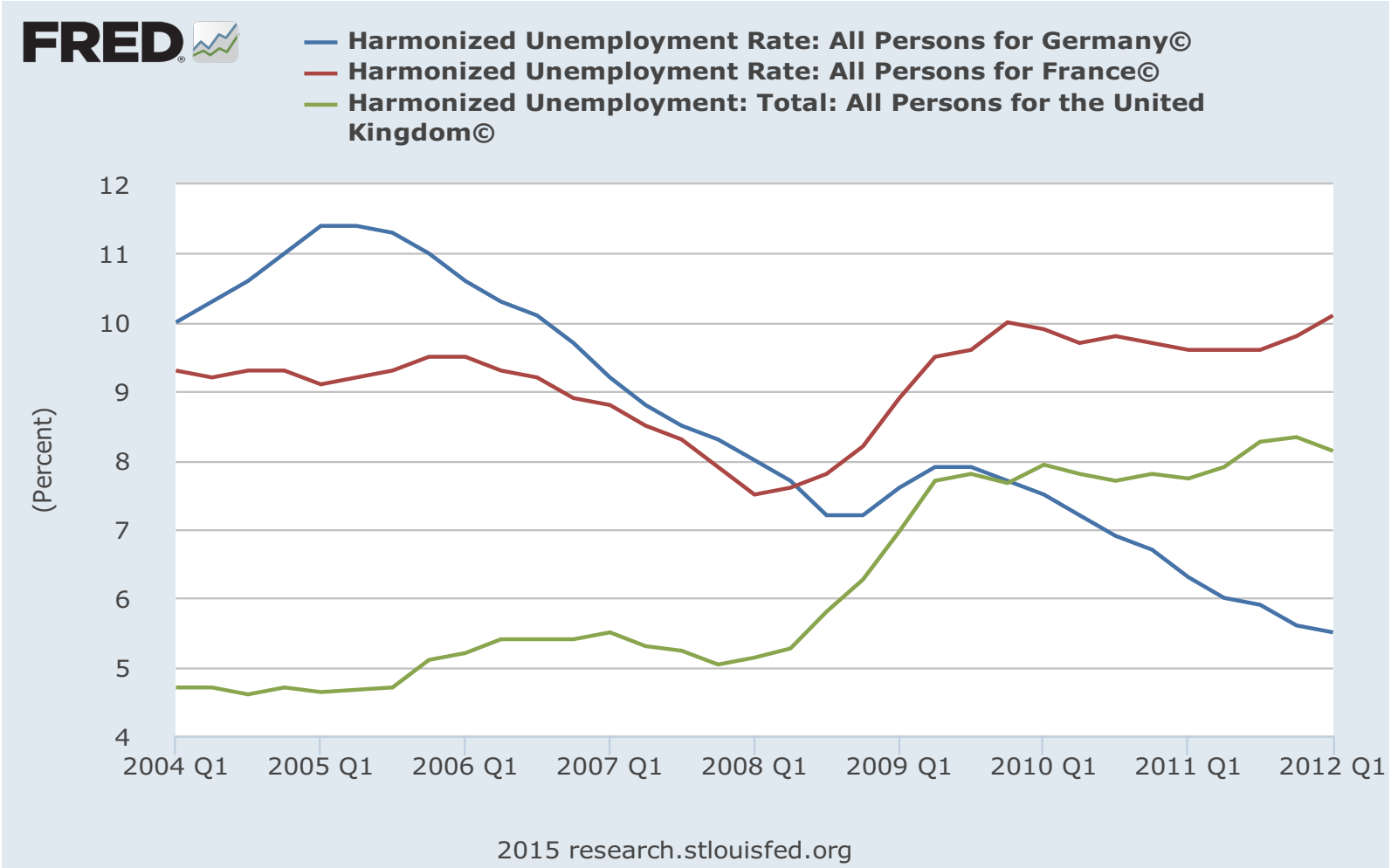

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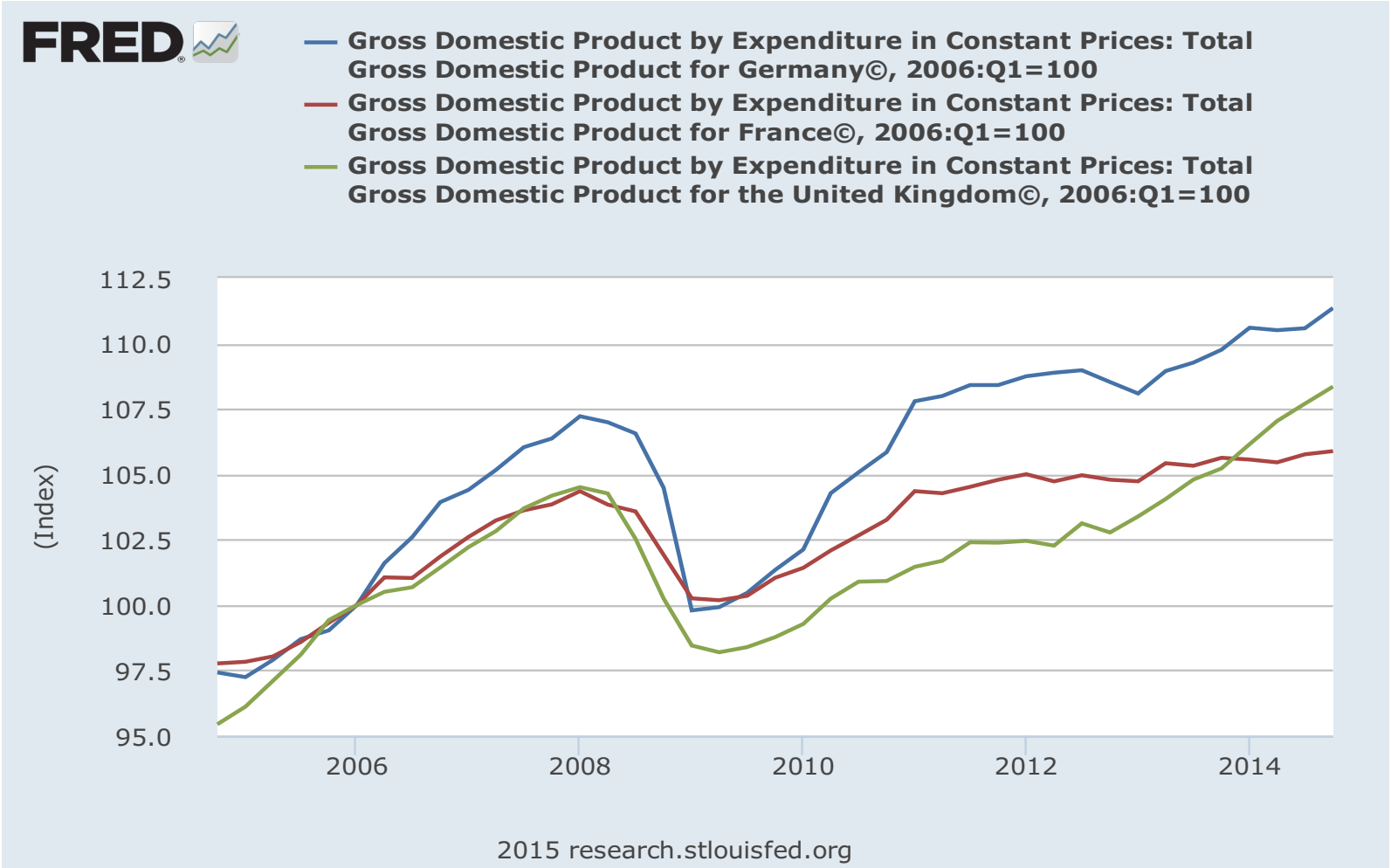

Comment IV - VAT - Unrelated to Economic Conditions?

- You need to show much more of the narrative evidence that it really was unrelated to (future) economic conditions, not just state it.
- How can fiscal consolidation be unrelated to (future) economic conditions?

Comment V - VAT - Exclusion Restriction

- You "test" the exclusion restriction using income and income expectations and find no effect of the VAT increase.
- Why not use many more expectations from the survey, including the ones with respect to macroeconomic variables, for this test?

Comment VI - VAT - Exclusion Restriction

Here is a policy trust story: people like that the fiscal house is in order now. The taxes they would have to pay anyway (and if BES are right, inflation expectations do not matter for pure intertemporal substitution). And that it is done by VAT increases (which tend to be regressive) rather than something else helps explain why the rich are happy and buy more durables (the fact that the VAT for necessities was not changed may make this somewhat less problematic, but still).

Variant of this story: maybe the rich are simply happy that the conservatives won after 7 years of leftist reign.

Comment VII - VAT - Other Things Going On in the Tax Code

- Some payroll taxes were lowered – enough to explain the consumption increase?
- Top marginal tax rates were raised by 3 percent (could contradict the policy trust story).

Comment VIII - VAT - From VAT to Inflation Expectations

- Why did the inflation expectations of professional forecasters not react?
- I do not think that the well-anchored argument is a good one, as this is a salient VAT change. Inflation actually did increase (as emphasized in the paper) and yet the professionals did not see it coming?
- Might it have to do with the qualitative and second-difference nature of the inflation expectation dummy in the baseline case? This would be worrisome.

Comment IX - VAT - Bigger Picture

- Careful with what we can learn for monetary policy.
- This might be a much more salient thing than we might be able to do with monetary policy. At the very least - communication would have to be crystal-clear.
- The salience is very much consistent with the BBS result on "good" inflation forecasters, which are presumably the ones who follow the economic news.

Comment X - VAT - Bigger Picture

- Aren't we really just dealing with an expected relative price change?
- After all, nondurables are much more likely to be subject to the reduced VAT rate and thus not effected.
- This is consistent with the BBS result on houses.
- But - what does that teach us about monetary policy?
- Can the results on saving alleviate this concern?

Comment XI - Some Recent More Structural Approaches

- Bahaj and Rendahl – *Deconstructing the Fiscal Multiplier*: use standard Neokeynesian model and professional forecaster data to estimate the expected inflation and the expected output channel for the fiscal multiplier and come out strongly for the expected output channel.
- Kaplan, Moll and Violante – *Monetary Policy According to HANK*: in a world with uninsurable income risk and illiquid assets (many de facto hand-to-mouth consumers) monetary policy works almost entirely through general equilibrium quantity effects and not the interest rate.

Conclusion

Nice paper, clever idea, but better acknowledge the limitations of your results.