

Research [in] Brief

Do Prices of Certain Goods Distort Consumers' Inflation Expectations?



Primary issue

When formulating their inflation expectations, consumers appear to put more emphasis on the prices they see more often, such as those for food, clothing, and new vehicles, rather than weighting them in line with their actual spending. Conversely, professional forecasters focus on a basket of goods and services that are weighted according to consumers' actual spending habits, that is reflected in the consumer price index (CPI).



Key findings

Researchers used a method called “least absolute shrinkage and selection operator,” or LASSO, to determine a statistical model for explaining inflation expectations for consumers and for professional forecasters. Using LASSO, they determine what affects these expectations most, and they find striking differences between the things prioritized by each group.

Professional forecasters' inflation expectations of have tended to move with inflation in categories that have also tended to be relatively more important in the CPI. This is not the case for consumers. The onset of the COVID-19 pandemic induced idiosyncratic increases in prices for different goods, generating potential rifts in how consumers adjusted their inflation expectations relative to how professional forecasters adjusted theirs. There were abnormal increases in food and vehicle prices, for example, because of supply chain and other issues with accessibility. These increases seem to have disproportionately affected consumers' inflation expectations while only slightly affecting professional forecasters' expectations.

Consumers' inflation expectations affect their economic decisions, so changes in these expectations have the potential to affect consumption.



The bottom line

The resulting discrepancy between consumers' inflation expectations and those of professional forecasters and the actual CPI has relevant economic implications that may affect consumers' current and future economic behavior. However, there is the opportunity to communicate about the nature of these price changes of specific goods and services in order to influence consumers' inflation expectations and to perhaps help avoid higher inflation outcomes.

Want to find out more? Read “Understanding Which Prices Affect Inflation Expectations” at clevelandfed.org/ec202206.

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