Assignment 2 : Expectations

Laimer Gerhard

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1 Questions about the paper.

The following answers are based on Blinder et al. [1] and D'Acunto et al. [2].

1.1 Questions Part 1a)

Can central bank communication be used as an instrument to affect the inflation expectations of the general public?
Answer: Central bank communication can be used as an instrument to influence the inflation expectations of the general public, but it faces important limitations, both on the side of the central banks and on the side of the audience. Starting with the central bank's perspective, communication is still mostly targeted at expert audiences. The terminology is often too technical for the general public to understand.[1] While the European Central Bank has started to reach out more broadly, for instance through its Consumer Expectations Survey (CES) to better understand household expectations and behavior, much of its official communication remains complex and difficult to access. From the perspective of the general public, inflation expectations are highly heterogeneous and often display an upward bias. Many households extrapolate future inflation from their past experiences and salient price changes in everyday life, such as grocery shopping. For most consumers, these personal price experiences remain the most important source of information about inflation.[2] Moreover, there is evidence of heterogeneity across demographic and cognitive dimensions: individuals with lower financial literacy or IQs tend to react less systematically to inflation information, while those with higher IQs behave more in line with the consumer Euler equation. Groups that have been historically underrepresented in policymaking institutions—such as women or African Americans—also tend to display lower levels of trust in central banks and adjust their expectations less in response to policy communication. Overall, while central banks made progress in improving transparency, their communication has only limited influence on the public's inflation expectations. Effective communication requires simpler language, relatable examples, and sustained efforts to build trust. The empirical evidence also suggests that households are more attentive and informed in high inflation environments compared to periods where it is low and stable.

What can be learned from the empirical evidence on central bank communication and inflation expectations about this question?
Answer: The empirical evidence suggests that central bank communication can shift households' inflation expectations, but the effects are modest and temporary. The evidence also indicates that communication is more effective in high-inflation environments than in periods of low and stable inflation. In general, people need to receive simple information, and if they do so, their expectations move closer to the target but usually fade within months. Individuals with higher IQs and financial education adjust their expectations different compared to individuals with lower IQs. Survey show that clear and relatable communication improves understanding and helps to better anchor inflation expectations.

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[1]One exception is the Bank of Jamaica, which uses creative communication strategies, such as comparing that low and stable inflation is to the economy what the bassline is in reggae music, to make monetary policy relatable.

[2]These backward-looking perceptions help explain why household inflation expectations tend to exceed actual inflation rates.

What makes central bank communication more effective according to existing research?
Answer: Trust by the public in the central bank and its credibility are the foundation and are extremely important for effective communication. Simple, clear and relatable communication that relates policy goals to individuals experiances, for example how stable prices protect purchasing power. The effectiveness is also increased if the communicated information is repeated and consistent across different channels.

1.2 Questions Part 1b)

What is your personal impression of central bank communication by the ECB or the U.S. Fed?
Answer: In my opinion, the ECBs communication is difficult to understand for individuals who are not familiar with economic terminology or monetary policy. The statements and publications on the ECBs website are not written in the most accessible or simplified way, which makes it challenging for the general public to engage with this material. It sometimes appears that there is either insufficient intention or limited resources, to truly interact with the general public. On the otherhand, communication with professionals seems to work well, as inflation expectations among experts have remained relatively anchored in recent years.

Was it effective at steering people's expectations during the recent surge and decline of inflation?
Answer: During the recent surge and subsequent decline of inflation, the ECB's communication appears to have had only limited effectiveness in steering the expectations of the general public. Although the ECB consistently emphasized its commitment to price stability, survey data show that household inflation expectations rose and remained volatile[3]. Communication was clearer and more credible for financial markets, where expectations stayed better anchored. The ECB's message that inflation would gradually decline eventually proved correct, which may have helped to rebuild some credibility. Additionally, in high-inflation environments it is easier to steer expectations, since communication can be reinforced by conventional monetary policy actions. To conclude, communication supported the normalization of expectations but was far less effective among ordinary citizens than among experts, confirming the challenges highlighted in recent research.

1.3 Questions Part 1c)

Discuss a new, creative idea how central bank communication with the general public could be improved. Explain the goal of your proposal and its underlying concept, the content, the communication channel and the expected reception by consumers. **Answer:** In my opinion, central banks need to penetrate different channels of communication to reach diverse groups of society. A combination of long-term and short-term actions are required. The most sustainable approach would be if they start in schools by introducing a subject like EU Institutions, where students learn what the EU is and its institutions do, complemented by workshops in which representatives present their work and professions. In the short term, social media and streaming platforms are important channels, where the ECB could place short adds, explaining briefly basics

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[3] ECB-Statistics : Inflation Perceptions and Expectation

concepts or communicate their actions in an accessible fashion. For older audiences, public television and radio remain important channels. To sum up, there is not a single creative idea to improve communication, but a bundle of approaches that need to be considered to reach different groups. If the communication is understandable, easy and adapted to each audience, the reception by consumers would be very positive.

2 Project Inflation Expectations

2.1 Questions Part 2a)

Pick a country of your choice. Show two patterns characteristic for consumer inflation expectations as discussed in the NBER Working Paper based upon the survey data. Use either one-year ahead inflation expectations (variable C1120) or three-year ahead inflation expectations (variable C1220) as the main reference point for your analysis Use simple descriptive statistics or bivariate correlations for the analysis.

Answer: For the Question 2a) and 2c) *Austria* was chosen as the country of interest and *C1120 (one year ahead inflation expectations)* as the variable of interest. The two patterns characteristics of choice are the mean and median inflation expectations based on the *educational level* and the *extrapolation of expectations based on past prices*. Table 1 shows the mean inflation expectations and Figure 1 the median inflation expectations based on the education level. Both the mean and median inflation expectations are higher for the *Low* education level. The *extrapolation of expectations based on past prices* is shown in Figure 2 where the correlation of *C1120* and *C1020* is 0.5267, confirming the extrapolation characteristic.
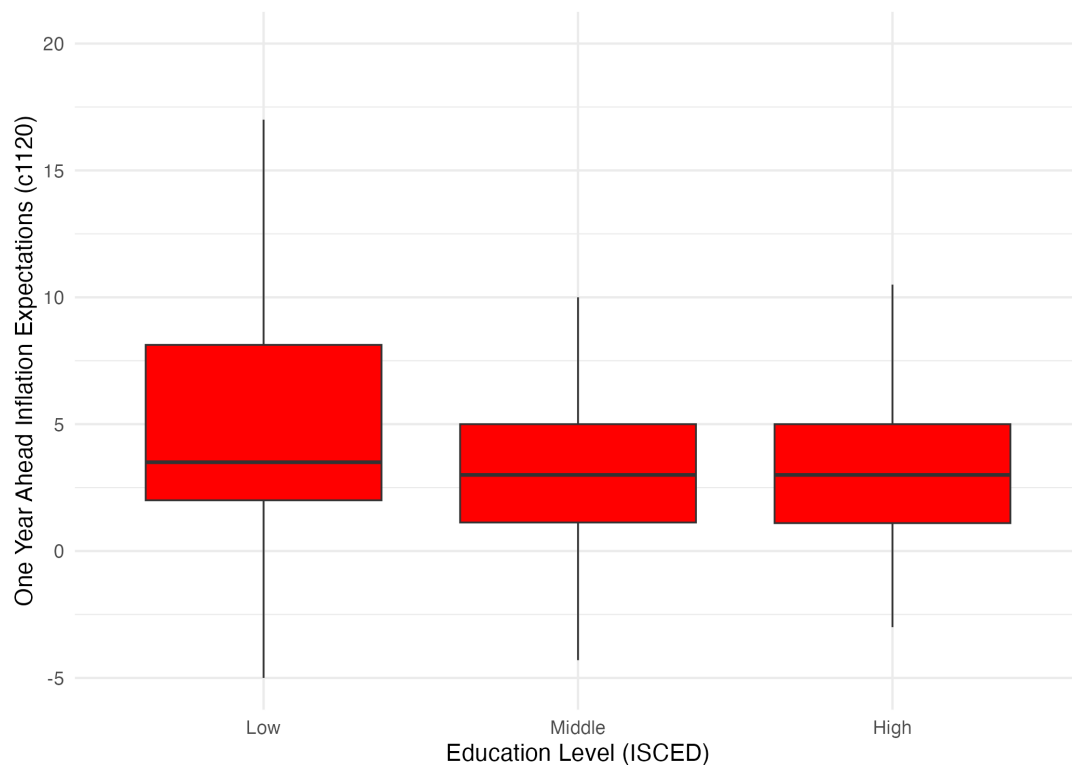

Figure 1: Median Inflation Expectations by Educations Level in Austria (2024)

Education Level (ISCED)	Mean Expected Inflation (%)
1	6.18
2	4.17
3	4.49

Table 1: Average One-Year-Ahead Inflation Expectations by Education Level (Austria, CES 2024)
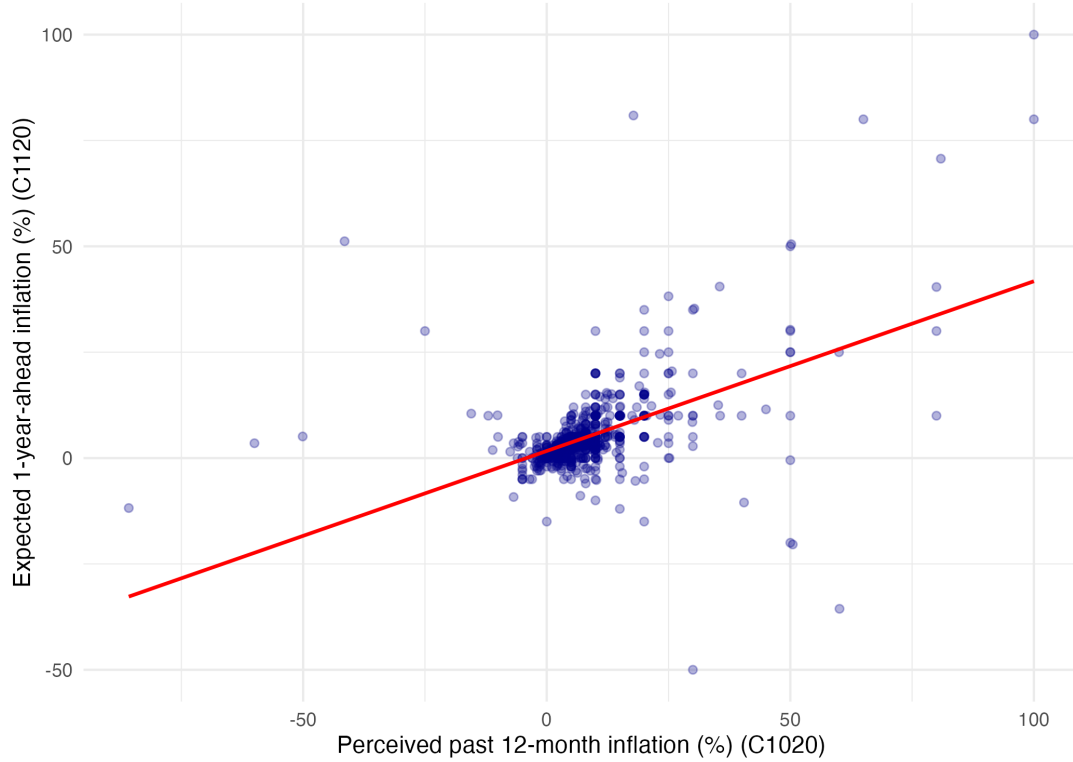

Figure 2: Extrapolation Pattern in Austria (perceived prices vs. expected inflation)

2.2 Questions Part 2b)

Calculate the difference between the one-year ahead inflation expectation (variable C1120) and the actual inflation rate in August 2025 of your chosen country as a measure for the expectations error. Explain this error econometrically by analyzing heterogeneity among consumers. How do consumers differ who are good at assessing future inflation from those who are bad? Can you come up with an explanatory factor not mentioned in the two papers?

Answer: The model in Table 2 tries to explain the expected error for the *C1120 (one year ahead inflation expectations)* and the actual annual rate of change in inflation rate for Austria in August 2025 of 4.1, provided by Eurostat. If coefficients are positive, the variable overestimated actual inflation while if it is negative, actual inflation was underestimated. Baseline categories are low for *Education*, male for *Gender*, 18 − 34 for *Age*, low for *Trust*, 1st Quintile for *Income*, insufficient for *Liquidity* and owner-occupied

	Dependent variable:		
	Expectation error (pp)		
	(1)	(2)	(3)
Education: Middle	−1.706**	−1.686**	−1.671**
	(0.717)	(0.717)	(0.716)
Education: High	−1.828**	−1.750**	−1.806**
	(0.772)	(0.773)	(0.771)
Extrapolation (past prices)	0.403***	0.402***	0.403***
	(0.021)	(0.021)	(0.021)
Gender: Female	−0.392	−0.438	−0.353
	(0.490)	(0.491)	(0.490)
Age: 35–49	−0.408	−0.423	−0.489
	(0.630)	(0.630)	(0.632)
Age: 50–70	−0.418	−0.413	−0.545
	(0.663)	(0.663)	(0.668)
Age: 71+	−0.988	−0.882	−1.178
	(1.187)	(1.188)	(1.193)
Trust (Medium)	−1.843***	−1.796***	−1.851***
	(0.562)	(0.563)	(0.562)
Trust (High)	−1.272*	−1.184*	−1.267*
	(0.693)	(0.695)	(0.694)
Income: 2nd Quintile	−0.378	−0.285	−0.570
	(0.755)	(0.757)	(0.760)
Income: 3rd Quintile	−1.421*	−1.270	−1.722**
	(0.782)	(0.789)	(0.799)
Income: 4th Quintile	−0.349	−0.157	−0.687
	(0.777)	(0.788)	(0.793)
Income: 5th Quintile	−1.145	−0.869	−1.572*
	(0.789)	(0.812)	(0.817)
Liquidity: Sufficient		−0.814	
		(0.566)	
Housing_2: Owner occupied (no mortgage)			0.570
			(0.683)
Housing_3: Rented / Free of Rent			−0.672
			(0.638)
Constant	1.420	1.815*	1.845
	(1.003)	(1.039)	(1.123)
Observations	922	922	922
R^2	0.326	0.328	0.329
Adjusted R^2	0.316	0.317	0.318

Table 2: Determinants of Inflation Expectation Errors (Austria, Aug 2024 → Aug 2025)

property with a mortgage outstanding for *Housing*[4]. For all three variations of the model the extrapolation based on past prices is positive and significant, suggesting this is a main driver in explaining a positive expectation error. For the explanatory variables of *Education* and *Trust*[5], it can be seen that the coefficients are significant and negative compared to the baseline of low *Education* and low *Trust* respectively. These significant coefficients explain the heterogeneity among consumers and are in line with the paper. *Age, Income* and *Gender* do not have a significant impact on explaining the expectation error, although the article mentions that under-represented groups have lower trust in the ECB, although this effect could already be covered by the *Trust* variable. For the two variations of the baseline model two variables not mentioned in the paper were added, which are *Liquidity* and *Housing*. The findings show that these variables do not add much explanatory power.

2.3 Questions Part 2c)

Blinder et al. repeatedly argue that many consumers have difficulties assessing future inflation. How does this feature show up in the ECB consumer expectations survey, particularly in variables C1120 and C1220?
Answer: Figure 3 shows that the density for consumer expectations are higher at focal points like 0, 5 or 10. For the one year ahead inflation expectations (*c1120*) 29% of the data lies on these three points and for the three year ahead inflation expectations (*c1220*) 30% of the data lies on these three points. This suggests that a larg number of respondents are uncertain and have limited numerical confidence and therefore provide a rough estimate.

How does the survey allow consumers to express unease with these questions?
Answer: It deals with the unease such that it asks for the best estimate, which makes the respondents to guess. If respondents don't know or are unsure they could skip the question, but there is no option to state that in the question design. A work around for that could be the previous questions *c1110* and *c1210*, where respondents could state that prices would stay exactly the same. If respondents answer like that, the value collected for the ahead inflation expectations questions *c1120* and *c1220* is zero. This could also explain why the most observed value for both questions is zero.

Could this issue affect the typically upwardly biased average consumer inflation expectations?
Answer: Yes this could affect the typically upward bias. One of the reasons is that if consumers are uncertain about future inflation, they tend to overestimate inflation rather than underestimate and to give rounded or exaggerated answers. Additionally, respondents tend to extrapolate past inflation experiences, which also could explain the upward bias.

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[4]Housing_2 refers to owner-occupied property without a mortgage outstanding and Housing_3 to Rented house/flat or accommodation provided free of rent.

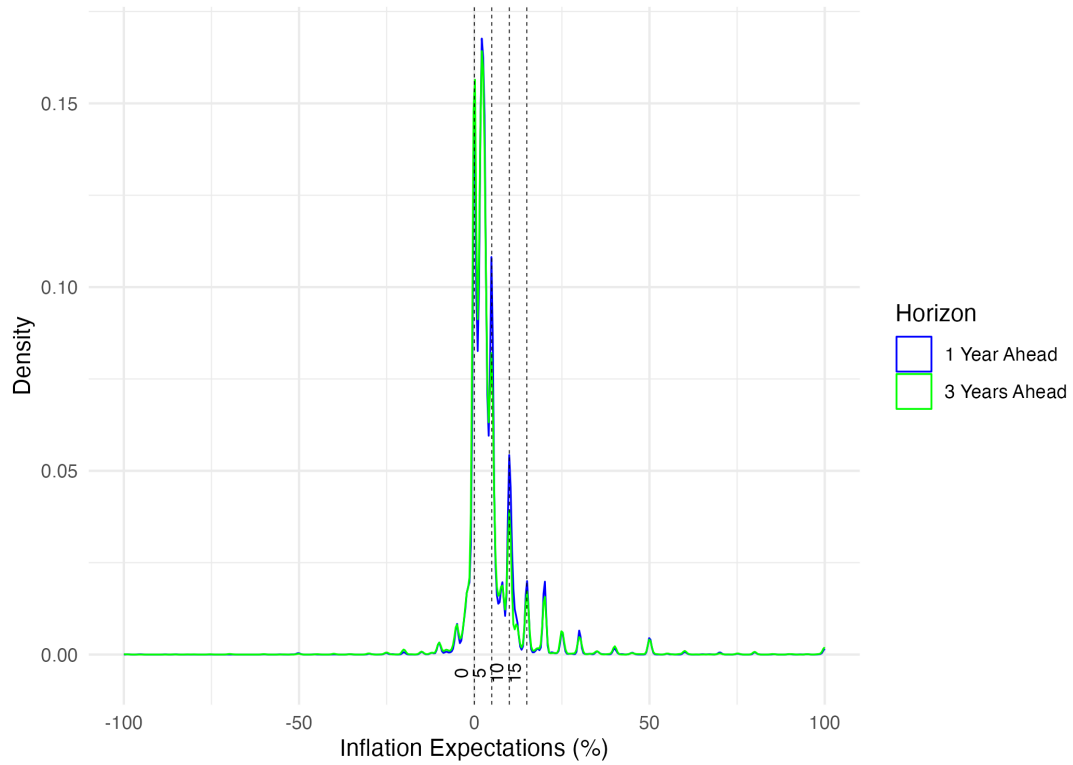[5]Trust refers to, how trustworthy respondents think the ECB is.

Figure 3: Density of one-year and three-year ahead inflation expectations in Austria (CES 2024).

References

[1] Blinder, A. S., Ehrmann, M., De Haan, J., and Jansen, D.-J. (2024). Central bank communication with the general public: Promise or false hope? *Journal of Economic Literature*, 62(2):425–457. https://www.aeaweb.org/articles?id=10.1257/jel.20231683.

[2] D'Acunto, F., Charalambakis, E., Georgarakos, D., Kenny, G., Meyer, J., and Weber, M. (2024). Household inflation expectations: An overview of recent insights for monetary policy. https://www.nber.org/papers/w32488.