Uncovering Subjective Models from Survey Expectations

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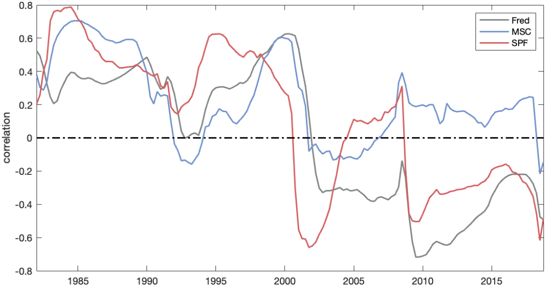
π_t and ΔU_t: Actual versus Perceived



Correlation using 10-year rolling window, 1982-2024. Grey line: realized data from FRED. Blue line: expectations from MSC. Red line: expectations from SPF.

Intro

Theme of the paper

- Macroeconomic expectation are formed jointly regarding multiple variable**s**
- Deviation from FIRE is due to both incomplete information and subjective models
- Inflation expectations are somewhat special...
  - supply view versus demand view (Andre et al., 2022; Han, 2023)
  - optimistic versus pessimistic sentiment factor (Kamdar, 2019)
  - people just *don't like* inflation (Shiller, 1997; Stantcheva, 2024)
  - households see PE but not GE mechanisms

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  - π news is always perceived to be bad, whereas the un news is neutral
  - π_t not un_t drives newspapers to draw connections between inflation and unemployment rates

Modeling framework

- Formal tests of expectation formation (Coibion and Gorodnichenko, 2012, 2015)
    - A Noisy information model Lucas (1976); Woodford (2001); Sims (2003)
    - Multivariate expectation formation ("Joint learning")
    - Subjective models (perceived law of motion $\neq$ actual law of motion) $\rightarrow$ correlated expectations

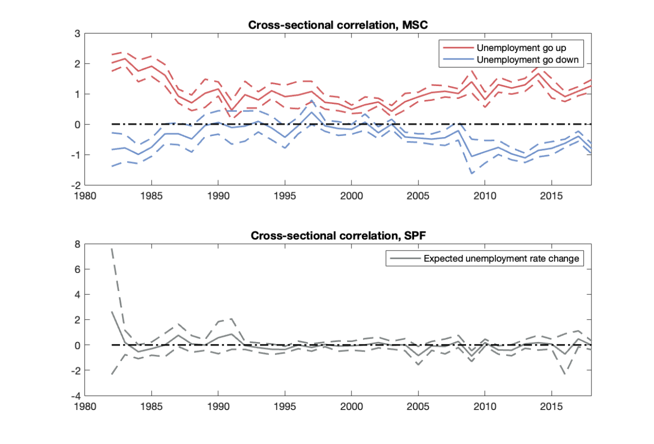
Facts

Correlation in consensus expectations

Table 1: Correlations: 1981q3-2018q4

	MSC	SPF	FRED
$corr(E\pi, Eun)$	0.16^{**}	0.03	0.00
$corr(E\pi, Ey)$	-0.25^{***}	-0.01	0.08

Time variations of the perceived correlation in consensus expectations



MSC: estimates β_1 from: $E_{i,t}\pi_{t+12,t} = \beta_0 + \beta_1 U_{t+12,t} + \theta\mu_i + D_t + \epsilon_{i,t}$, where $U_{t+12,t}$ stands for two dummy variables indicating the MSC consumer believes the unemployment rate will go up or down in the next 12 months. SPF: estimated β_1 from: $E_{i,t}\pi_{t+4,t} = \beta_0 + \beta_1 E_{i,t}un_{t+4,t} + \theta\mu_i + D_t + \epsilon_{i,t}$. Where $E_{i,t}un_{t+4,t}$ stands for

Controlling for individual FE and time FE

$$E_{i,t}\pi_{t+12,t} = \beta_0 + \beta_1 E_{i,t}un_{t+12,t} + \beta_2 E_{i,t}i_{t+12,t} + \theta X_{i,t} + D_t + \mu_i + \epsilon_{i,t}$$

Table 2: FE Panel Regression

	MSC		SCE		SPF
Unemployment up	0.30^{***}	$\hat{\beta}_1$	0.012^{***}	$\hat{\beta}_1$	-0.17^{***}
	(0.05)		(0.002)		(0.06)
Unemployment down	-0.22^{***}				
	(0.05)				
FE	Y		Y		Y
Time dummy	Y		Y		Y

* Controlling for individual and time-varying characteristics, individual fixed effect, and time-fixed effect. Standard errors are adjusted for heteroscedasticity and autocorrelation.

Time-varying correlations across individuals

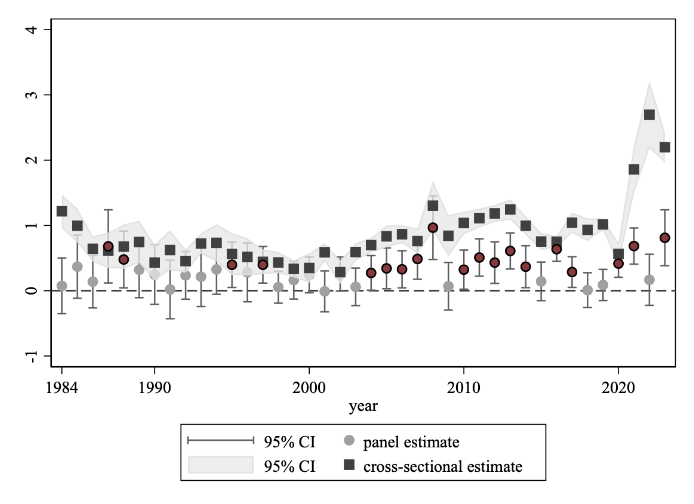


Figure 1: Individual level correlation between $E_{i,t}\pi_{t+4,t}$ and $E_{i,t}\Delta un_{t+4,t}$ in each year. The square marks: without individual FE but with controls for characteristics. The circle marks: with individual FE.

A Formal Test of Joint Learning

A multivariate noisy information + subjective model

$$\boldsymbol{L}_{t+1,t} = A\boldsymbol{L}_{t,t-1} + w_{t+1,t} \tag{1}$$

$$\boldsymbol{s}_t^i = G\boldsymbol{L}_{t,t-1} + v_t^i + \eta_t \tag{2}$$

$$\boldsymbol{L}_{t+1,t} = \hat{A}\boldsymbol{L}_{t,t-1} + w_{t+1,t} \tag{3}$$

$$w_{t+1,t} \sim N(0, Q) \quad \epsilon_{i,t} := v_t^i + \eta_t \sim N(0, R) \tag{4}$$

- A: Actual law of motion (ALM)
- $\hat{A}$: Perceived law of motion (PLM)
- G: signal mixture
  - Correlated signals: G is non-diagonal
  - Uncorrelated signals: G is diagonal

Serial correlations of forecast errors (FE)

$$
\begin{aligned}
FE^{i}_{t+1,t|t} &\equiv \boldsymbol{L}_{t+1,t} - \boldsymbol{L}^{i}_{t+1,t|t} \\
&= \hat{A}(I - KG) FE^{i}_{t,t-1|t-1} \\
&+ \underbrace{M}_{(A - \hat{A}KG - \hat{A}(I - KG))} \boldsymbol{L}_{t,t-1} + w_{t+1,t} - \hat{A}K\left(v^{i}_{t} + \eta_{t}\right)
\end{aligned}
$$

- K: Kalman gain

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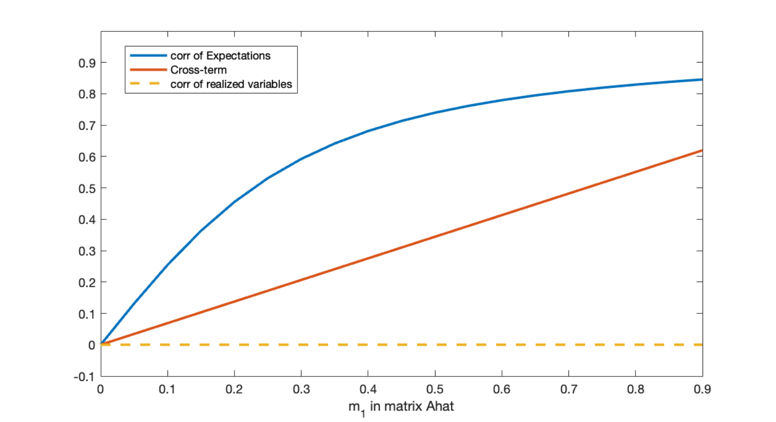
- K: Kalman gain
- Diagonal terms of $\hat{A}(I - KG)$: auto-correlation
- Off-diagonal terms: between-correlation
- Special case of FIRE: $A = \hat{A}$ and $G = I$, $K = I \rightarrow \hat{A}(I - KG) = \mathbf{0}$
- Special case of independent learning: $\hat{A}$, G are diagonal $\rightarrow$ so is $\hat{A}(I - KG)$

Joint-learning scenario 1: subjective model, i.e. $\hat{A} \neq A$

$$\begin{aligned} \hat{A}(I - KG) &= \begin{pmatrix} \rho_1 & m_1 \\ m_2 & \rho_2 \end{pmatrix} \times \begin{pmatrix} \frac{\sigma_{1,s}^2}{\sigma_1^2+\sigma_{1,s}^2} & 0 \\ 0 & \frac{\sigma_{2,s}^2}{\sigma_2^2+\sigma_{2,s}^2} \end{pmatrix} \\ &= \begin{pmatrix} \frac{\sigma_{1,s}^2 \rho_1}{\sigma_1^2+\sigma_{1,s}^2} & \frac{\sigma_{2,s}^2 m_1}{\sigma_2^2+\sigma_{2,s}^2} \\ \frac{\sigma_{1,s}^2 m_2}{\sigma_1^2+\sigma_{1,s}^2} & \frac{\sigma_{2,s}^2 \rho_2}{\sigma_2^2+\sigma_{2,s}^2} \end{pmatrix} \end{aligned} \tag{5}$$

- $G = I_2$: no signal correlation (can be any diagonal matrix)
- The signs of cross terms (the between-variable serial correlation of FEs) have the same signs as the perceived correlation

Scenario 1: an example



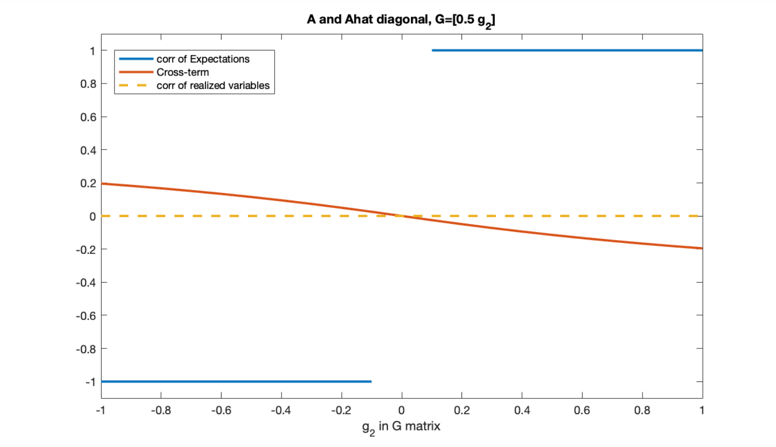
$$A = \begin{pmatrix} 0.9 & 0 \\ 0 & 0.9 \end{pmatrix}, \hat{A} = \begin{pmatrix} 0.9 & m_1 \\ 0 & 0.9 \end{pmatrix}.$$

Joint-learning scenario 2: mixed signals, i.e. G is not diagonal

$$
\begin{aligned}
\hat{A}(I-KG) &= \begin{pmatrix} \rho_1 & 0 \\ 0 & \rho_2 \end{pmatrix} \begin{pmatrix} \frac{g_2^2\sigma_2^2+\sigma_s^2}{m} & -\frac{g_1 g_2 \sigma_1^2}{m} \\ -\frac{g_1 g_2 \sigma_2^2}{m} & \frac{g_1^2\sigma_1^2+\sigma_s^2}{m} \end{pmatrix} \\
&= \begin{pmatrix} \rho_1 \frac{g_2^2\sigma_2^2+\sigma_s^2}{m} & -\rho_1 \frac{g_1 g_2 \sigma_1^2}{m} \\ -\rho_2 \frac{g_1 g_2 \sigma_2^2}{m} & \rho_2 \frac{g_1^2\sigma_1^2+\sigma_s^2}{m} \end{pmatrix}
\end{aligned} \tag{6}
$$

- $G = [g_1, g_2]$: the vector of signals (due to "optimal signal selection")
- When signals go in the same direction, $g_1 g_2 > 0$, the cross terms are negative.

Scenario 2: an example



$$\hat{A} = A = \begin{pmatrix} 0.9 & 0 \\ 0 & 0.9 \end{pmatrix}, \; G = \begin{pmatrix} 0.5 & g_2 \end{pmatrix}.$$

Model predictions

Table 3: Summary of Models and Testable Implications

Model:	Implied Estimate Results
FIRE	$\beta_{11} = \beta_{12} = \beta_{21} = \beta_{22} = 0$, $corr(E\pi, Edun)$ same as realized $corr(\pi, dun)$
Independent Learning: $m_1 = m_2 = 0$, G diagonal	$\beta_{12} = \beta_{21} = 0$, $\beta_{11}, \beta_{22} \neq 0$, $corr(E\pi, Edun) = 0$
Joint Learning: $m_i \lesseqgtr 0$, $m_j = 0$, G diagonal	$\beta_{ij} \lesseqgtr 0$, $\beta_{ji} = 0$, $corr(E\pi, Edun) \lesseqgtr 0$
Joint Learning: $m_1 = m_2 = 0$, $G = \begin{pmatrix} g_1 & g_2 \end{pmatrix}$, $g_1 g_2 \lesseqgtr 0$	$\beta_{12} \gtreqless 0$, $\beta_{21} \gtreqless 0$, $corr(E\pi, Edun) \lesseqgtr 0$

Joint-learning tests for π and *un*

$$\begin{pmatrix} fe^{\pi}_{t+1,t|t} \\ fe^{un}_{t+1,t|t} \end{pmatrix} = \boldsymbol{\beta}_0 + \begin{pmatrix} \beta_{11} & \beta_{12} \\ \beta_{21} & \beta_{22} \end{pmatrix} \begin{pmatrix} fe^{\pi}_{t,t-1|t-1} \\ fe^{un}_{t,t-1|t-1} \end{pmatrix} + \boldsymbol{\theta} X_{t,t-1} + e_t \quad (7)$$

- β_{12} and β_{21}: between-variable serial correlations of forecast errors
- Predictions: if only correlated signals but not subjective model, β_{12} and β_{21} are both negative.
- With imputed point forecast of *un* in MSC
- Using FEs 3 months apart

Joint-learning tests with consensus expectations

Table 4: Aggregate Test on Joint Learning, MSC v.s. SPF

	MSC		SPF	
	1981-2018	1990-2018	1981-2018	1990-2018
	(1)	(2)	(3)	(4)
β_{11}	0.61^{***}	0.65^{***}	0.63^{***}	0.61^{***}
	(0.066)	(0.085)	(0.056)	(0.086)
β_{12}	-0.15	-0.02	-0.17	0.00
	(0.094)	(0.102)	(0.181)	(0.221)
β_{21}	0.10^{***}	0.20^{***}	0.03	0.06
	(0.036)	(0.059)	(0.032)	(0.053)
β_{22}	0.59^{***}	0.50^{***}	0.41^{***}	0.40^{***}
	(0.080)	(0.092)	(0.101)	(0.143)
Observations	150	116	150	116

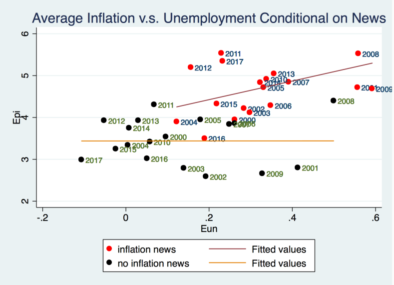
* The first and third columns are using full sample 1981-2018; the second and fourth columns are results for sub-sample 1990-2018. Newey-West standard errors are reported in brackets.

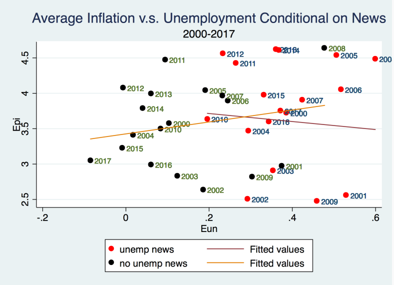
Mechanisms

Expectations conditional on the type of news heard

Expectation on:	Inflation	Likelihood Unemployment Increase
News on:	(1)	(2)
high inflation	0.50***	0.060***
	(0.09)	(0.011)
low inflation	−0.31***	−0.059***
	(0.10)	(0.016)
employment unfavorable	−0.001	0.10***
	(0.052)	(0.007)
employment favorable	−0.08	−0.14***
	(0.057)	(0.009)
financial market unfavorable	0.03	0.07***
	(0.074)	(0.011)
financial market favorable	−0.08	−0.08***
	(0.061)	(0.012)
Observations	163233	162369
R^2	0.68	0.69

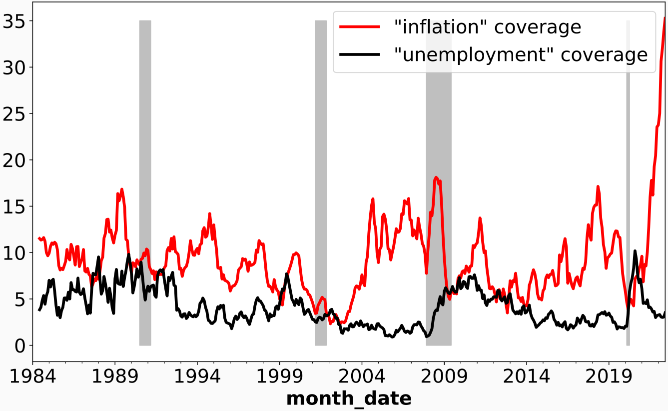
Consensus expectations conditional on the news exposure





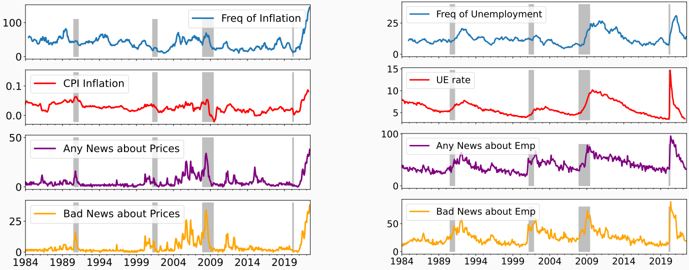
Scatter plot for consensus expected inflation and unemployment each year from 2000-2017. Left panel: conditional on having heard inflation news or not. Right panel: conditional on having heard unfavorable unemployment news.

Newspaper coverage of inflation and unemployment



The news coverage is defined as the sum of the ratio of the frequency of the word being mentioned divided by the total number of words in each article.

News on inflation and unemployment are domain-specific



News coverage measured in the WSJ news archive.

Inflation news is always labeled as bad news

Table 5: News Coverage and Self-Reported News Exposure

Topic	Any News	Bad News	Good News
Inflation	0.605	0.627	-0.048
Unemployment	0.373	0.295	0.153

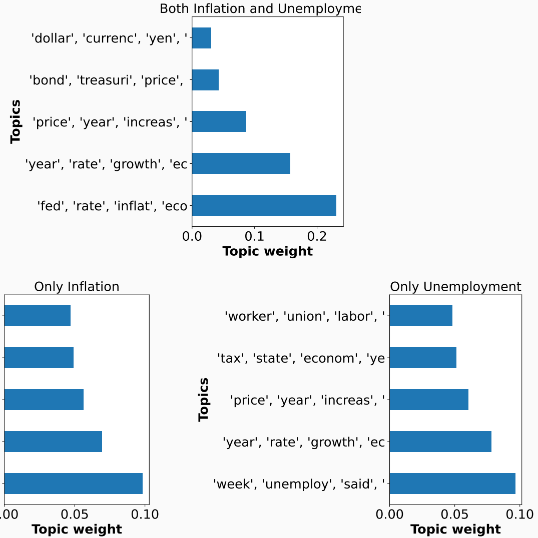
Inflation-unemployment associations in newspapers

	(1)	(2)	(3)
economy	1.07***	1.07***	1.07***
	(0.03)	(0.03)	(0.03)
fed	0.22***	0.21***	0.21***
	(0.03)	(0.03)	(0.03)
growth	0.60***	0.61***	0.61***
	(0.03)	(0.03)	(0.03)
oil price	0.24***	0.24***	0.24***
	(0.05)	(0.05)	(0.05)
recession	0.48***	0.47***	0.47***
	(0.03)	(0.03)	(0.03)
uncertainty	0.14***	0.15***	0.15***
	(0.05)	(0.05)	(0.05)
π_t		3.73***	3.62***
		(0.93)	(0.96)
u_t	-0.01		-0.00
	(0.01)		(0.01)
N	150465	150465	150465

Conclusion

- Households think about macroeconomic variables jointly
- $E(\pi) \uparrow \rightarrow E(un) \uparrow$
- Formal tests suggest the role of the subjective model in addition to correlated information
- π news triggers associations of π and *un* in expectations
- ... as well as newspapers' narratives
- Caution: $E(\pi)$ may have unintended contractionary effects

Topics in Inflation-Unemployment Narratives

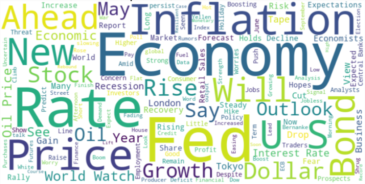


Top five topics identified by the topic model. Topic weights are between 0-1.

Keywords in Different Inflation-Unemployment Narratives

Key words when inflation, unemployment and Fed are mentioned

Key words when inflation, unemployment and oil price are mentioned



Key words when inflation, unemployment and recession are mentioned

Key words when inflation, unemployment and growth are mentioned

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