How Do Households Respond to Inflation? An Investigation of Transmission Mechanisms

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March 11, 2022
IU Macro Brown Bag

Survey

Please take the survey here:

https://iu.co1.qualtrics.com/jfe/form/SV_aYnPrIFzx57Q2hg

Our Goals:

1. get your feedback on the survey itself
2. gather your responses to see if trends immediately emerge

We will reconvene to discuss at 11:55.

Thank you!

Motivation

- Recent discussions have considered using inflation expectations as a policy tool:

  With nominal short-term interest rates at ... their effective lower bound. ... [C]entral banks have sought additional ways to stimulate their economies, including adopting policies that are directly aimed at influencing expectations of ... inflation.

  -Janet Yellen

- The idea is based on the standard consumption Euler equation
- Empirical evidence on the relationship between inflation expectations and consumption is mixed, and there is no systematic work on how people think about this relationship

Literature

- Survey-based research on consumption response to changes in inflation expectations - results are mixed and highlight heterogeneity
  - Bachmann et al. (2015), Duca-Radu et al. (2021), Coibion et al. (2021), D'Acunto et al. (2019)
- Inflation narratives - consumers dislike inflation and disagree about the causes(es) of it
  - Shiller (1996), Kamdar (2019), Andre et al. (2021)
- Subjective model of the macroeconomy - beliefs about inflation and unemployment are widely dispersed following hypothetical economic shocks
  - Andre et al. (2022)

Our Contribution

- Add to evidence on the relationship between inflation expectations and consumption and investigate heterogeneity
- Disentangle the different mechanisms that may guide households' consumption behavior in response to changes in inflation expectations and highlight heterogeneity (e.g., across demographics, durables vs nondurables, long-term vs short-term treatments)
    - intertemporal substitution from the consumption Euler equation
    - sentiment-based reactions
    - no change due to fixed budgets or borrowing constraints
    - wages are upwardly rigid
    - substitution away from labor due to an inflation tax
    - the interest rate will change more than 1-for-1 with inflation

Specific Questions for You

- Current treatments:
  - Long-/short-run - varying strength or different mechanisms selected?
  - Increase/decrease - asymmetric effects?
- Additional treatment ideas:
  - Information - intuitively describe the consumption Euler equation and assess if this results in larger changes in consumption
  - Interest rate - does forward guidance on the interest rate result in larger consumption changes than ‘forward guidance on inflation’

Specific Questions for You

- The mechanisms:
    - Description of the different mechanisms clear/confusing?
    - Formulation of questions sufficiently clear?
      "What do you think your household's total spending on durable goods in the next 3 months to be in the alternative [higher/lower] inflation scenario?
      Please enter a number greater than 0 or equal to 0.
      Answer: [dollars]"
    - Missing important mechanisms?
    - Listed too many mechanisms? Are differences between mechanisms salient?
    - A single top reason, or top three?

Additional Thoughts?

Questions, comments, or concerns?