Selective Inattention to Interest Rates

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Motivation

- Households' macro expectations suggest they are very uninformed on **average**
  - Level of expectations is often systematically biased Weber et al. 22
  - Substantial dispersion in expectations across people Mankiw et al. 04
  - Errors in their expectations are predictable ex-ante Bordalo et al. 20

- Motivated adding information frictions to quantitative macro models Auclert et al. 20
  - $\Rightarrow$ **Average** expectation is slow-moving and under-reacts Coibion-Gorodnichenko 12, 15
  - $\Rightarrow$ Aggregate responses to shocks are "hump-shaped", like in data Christiano et al. 05

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- Motivated adding information frictions to quantitative macro models Auclert et al. 20
- Introspection: macro expectations much more important for "**big**" decisions
  - These **big** decisions also tend to occur less frequently
  - Example: interest rates important when **buying a house**, but less so for groceries

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- **Question**: Do HHs **select** into paying attention based on **types** of decisions?

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- Introspection: macro expectations much more important for "**big**" decisions
- **Question**: Do HHs **select** into paying attention based on **types** of decisions?
- **If yes**, how do the macro implications of this **selection** differ?
  - Belief heterogeneity $\Rightarrow$ **average** may not be the relevant object Miller 77, Afrouzi et al. 24

This Paper

Is there selective inattention to interest rates based on **durables purchases**?

"decision-making" (DM)

1. Use existing surveys to study how interest rate expectations differ based on DM
   - Benefit: high-quality data on expectations
   - Cost: imprecise identification of **DM status** + hard to isolate attention

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Is there selective inattention to interest rates based on **durables purchases**?

"decision-making" (DM)

1. Use existing surveys to study how interest rate expectations differ based on DM
2. Conduct a new survey to identify how macro attention changes based on DM
   - Benefit: better identify **DM status** + elicit information acquisition directly
   - Cost: hard to study accuracy in expectations given one cross-section

This Paper

~~Is there selective inattention to interest rates based on durables purchases?~~ ✓

How does selective inattention affect **aggregate responses** to interest rates?

1. Use existing surveys to study how interest rate expectations differ based on DM
2. Conduct a new survey to identify how macro attention changes based on DM
3. Develop incomplete markets model with $\overbrace{\text{durables}}^{\text{DM in model}}$ + rational inattention to rates
   - Use patterns in IA from survey to discipline information cost parameter
   - Compare **model IRFs** to level and volatility of rates with $\underbrace{\text{exogenous inattention}}_{\text{DM} \perp \text{beliefs} \Rightarrow \text{no selection}}$

Outline

1. Existing Surveys: Expectations Accuracy around Decision-Making
2. New Survey: Information Acquisition around Decision-Making
3. Incomplete Markets Model with Selective Inattention
4. Interest Rate Passthrough with Selective Inattention
5. Conclusion

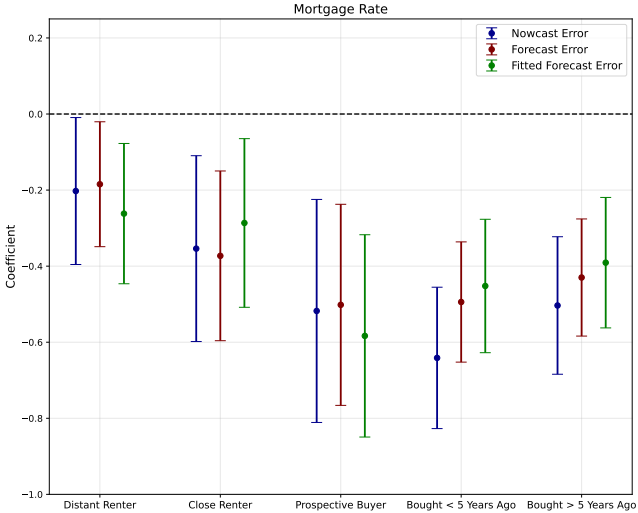
Outline

Survey 1/2: NY Fed Survey of Consumer Expectations

- **Sample**: repeated cross-section of $\sim$ 8K respondents in 2014-2023
- Variables of interest:
  1. **Nowcasts** of current average 30-year fixed mortgage rate
  2. **Forecasts** of one-year ahead mortgage rate and inflation
  3. **DM status** based on distance from past or (intended) future home purchase
- Construct errors using 30-year fixed rate in Freddie Mac PMMS and CPI
- Run the following regression:

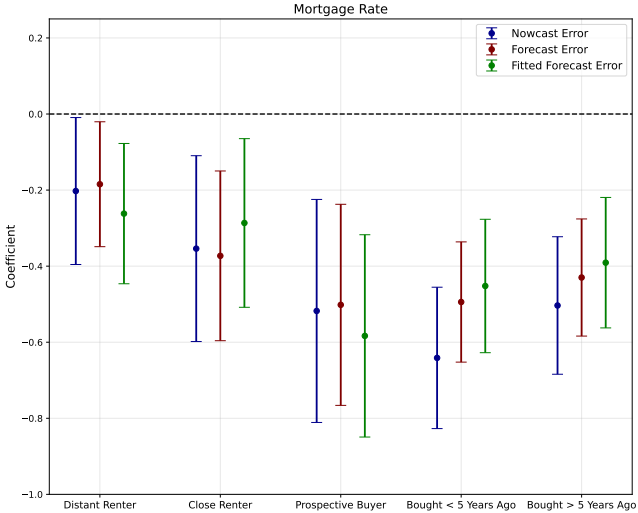
$$\log |\text{Error}_{it}| = \sum_s \beta_s \cdot \mathbf{1}\left(\text{DM Status}_{it} = s\right) + \text{Controls}_{it} + \delta_t + \epsilon_{it}$$

Decision-Makers Have More Accurate Beliefs



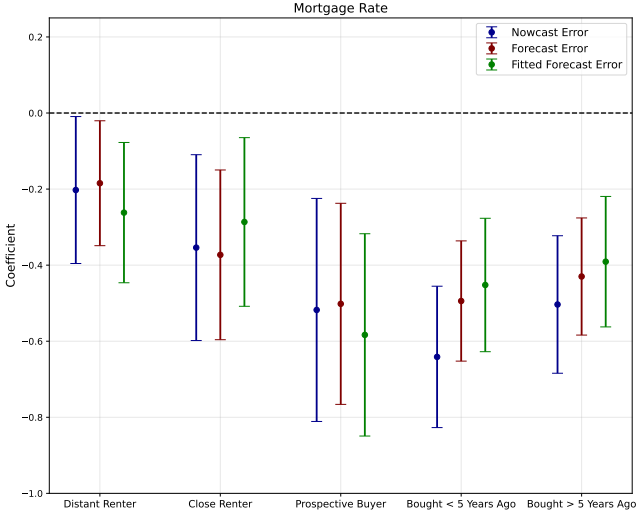
Errors of prospective buyers $\approx$ **50% lower** than those with no purchase plan

Decision-Makers Have More Accurate Beliefs



≈ **2x** difference between individuals in top and bottom terciles of income or education

Decision-Makers Have More Accurate Beliefs



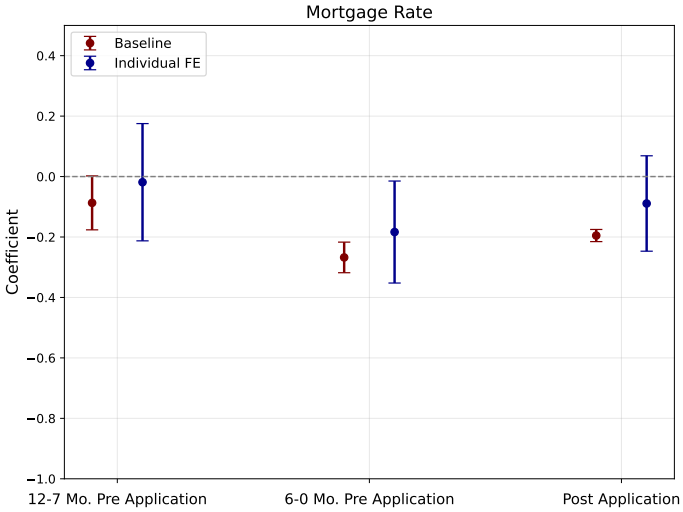
Almost all of forecasting gain comes from nowcasting improvement

Survey 2/2: ECB Survey of Consumer Expectations

- **Sample**: **panel** of $\sim$ 130K individuals in 2020-2024 from six largest countries
  - Restriction: only include individuals who rented at some point in survey
  - Note: quarterly frequency $\Rightarrow$ short panel
- Variables of interest:
  1. **Forecasts** of one-year ahead mortgage rates, inflation, GDP, and unemployment
  2. **DM status** based on distance from mortgage application
- Construct errors based on country-specific realizations
- Run the following regression:

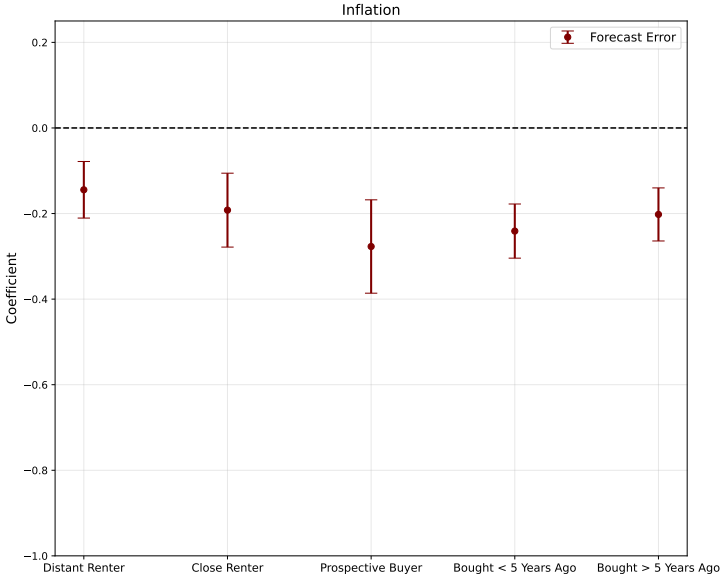
$$\log |\text{Error}_{it}| = \sum_s \beta_s \cdot \mathbf{1}\left(\text{DM Status}_{it} = s\right) + \text{Controls}_{it} + \textbf{Tenure}_{it} + \delta_t + \lambda_{\mathbf{i}} + \epsilon_{it}$$

Decision-Makers Have More Accurate Beliefs: ECB

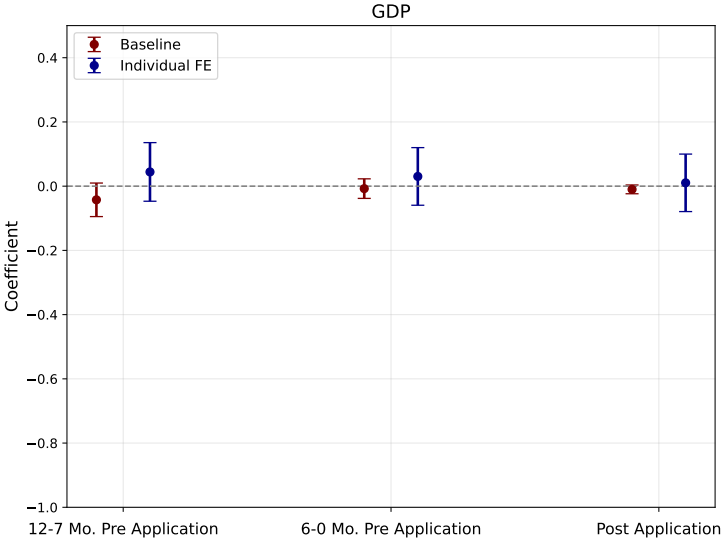


Mortgage rate forecast errors fall by about **20%** pre-application

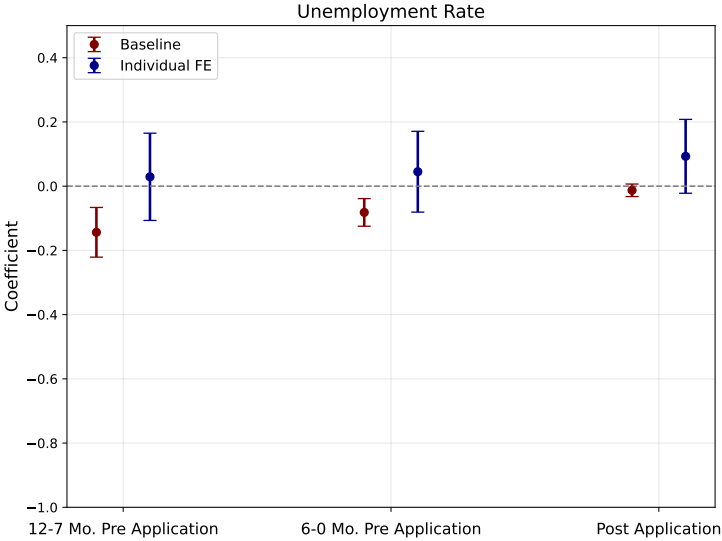
Smaller Differences for Other Variables: Inflation in NY Fed



Smaller Differences for Other Variables: GDP in ECB

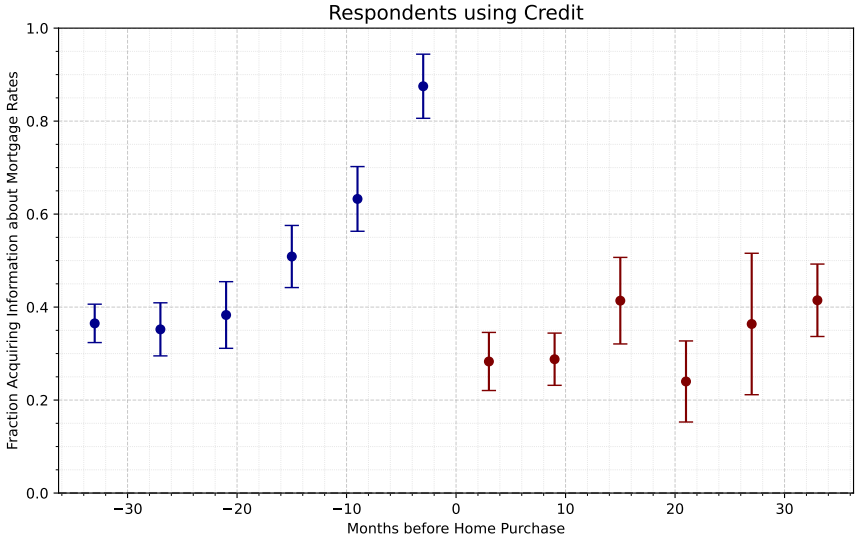


Smaller Differences for Other Variables: UR in ECB



Outline

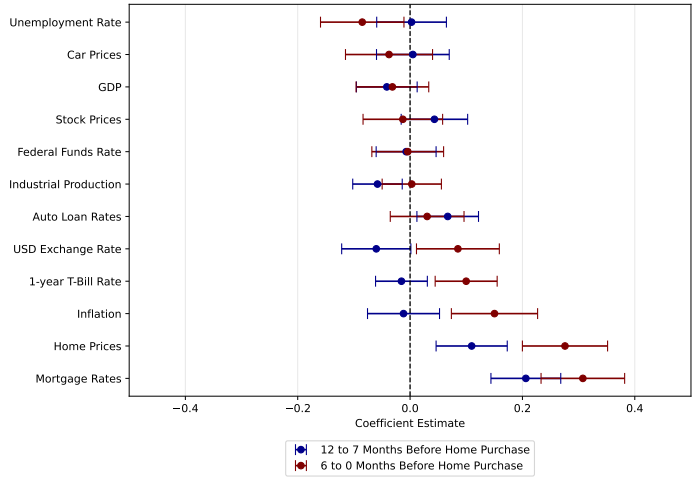
Information Acquisition is Concentrated Pre-Decision



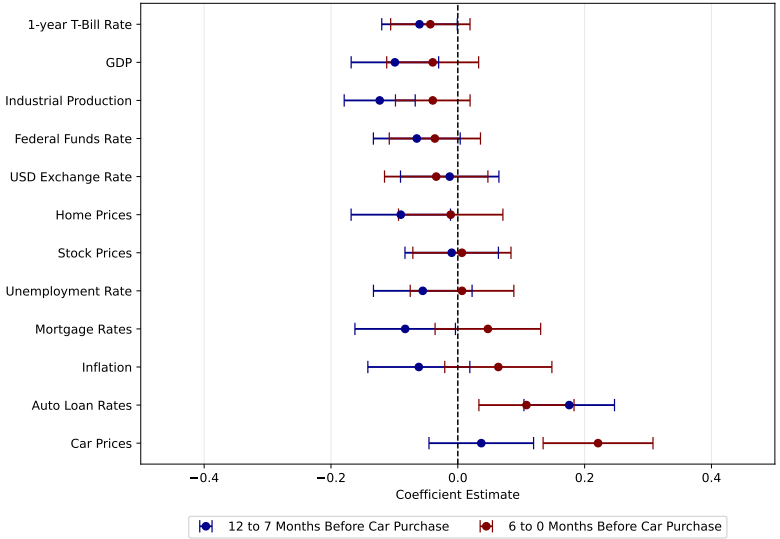
▸ Survey Description

IA IS CONCENTRATED ON DECISION-RELEVANT VARIABLES

$$\text{Info. Acquisition}_i = \sum_d \beta_d \cdot \mathbf{1}\left(\text{Home Distance}_i = d\right) + \text{Controls}_i + \text{Other Distances}_i + \epsilon_i$$



Patterns in Information Acquisition are Decision-Specific



Taking Stock: 5 Facts

1. Households close to **durables** purchases have more **accurate** macro expectations
2. Improvement in expectation accuracy is largest for **interest rates**
3. Decision-makers' beliefs are less **dispersed** and **uncertain** (see paper)
4. Households concentrate **information acquisition** around durables purchases
5. Households' information acquisition is about **decision-relevant variables**

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Next: what are the macroeconomic implications of this **selective inattention**?

Outline

Model Sketch

$$\overbrace{\underbrace{\text{Partial equilibrium incomplete markets model}}_{\text{household block of McKay-Wieland 2021}} + \text{durables}}^{\text{Bewley-Huggett-Aiyagari}} + \underbrace{\text{dynamic info. acquisition}}_{\text{rational inattention}}$$

Partial equilibrium incomplete markets model + durables + dynamic info. acquisition

Decision-Making

Given beliefs, HHs choose non-durables **c**
and durables **d**′ subject to:

- Income risk + collaterized borrowing
- Stochastic interest rate r
- Depreciation of durables stock
- Durables adjustment costs
- Operating + maintenance costs
- Match-quality shocks (e.g. job change)

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$$\Downarrow$$

Rich model of how beliefs about $r \longrightarrow \mathbf{c}, \mathbf{d}'$

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Information Acquisition

HHs know DGP + receive signals of endog. precision about r = rational inattention

- Cost of signals = $\omega \times$ mutual info.
- Benefit of signals = better choice of $\mathbf{c}, \mathbf{d}'$

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- Assumption: Gaussian signals about current r

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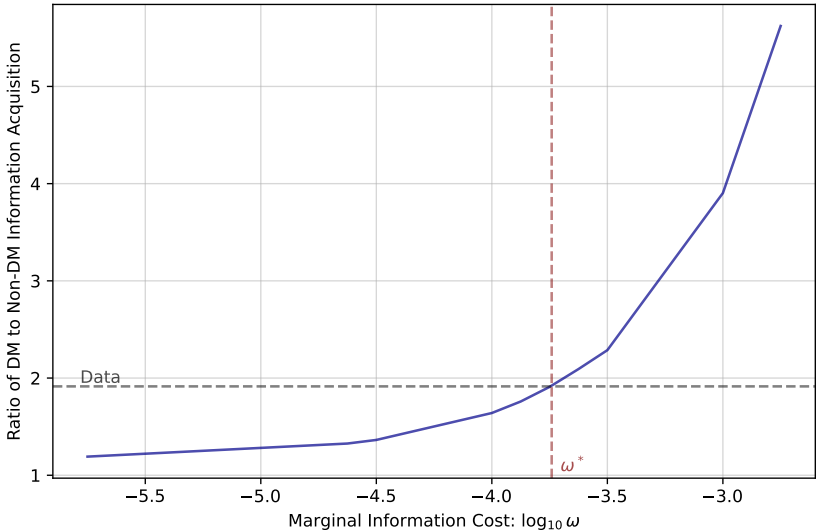
Endogenous beliefs about r that come from dynamic information acquisition

CALIBRATION

Parameter	Description	Value	Source
Internally-Calibrated			
β	Discount factor	0.9829	Asset-to-GDP ratio
ψ	Non-durables exponent	0.627	Durable-to-nondurable consumption ratio
f	Fixed cost	0.11	Adjustment probability
$1-\overline{\xi}$	Match-quality shock probability	0.034	Share of adjustments from MQ shocks
ω	Marginal information cost	$10^{-3.741}$	Concentration in information acquisition
Externally-Calibrated			
γ	RRA (and inverse EIS)	2	.
ε	Durables elasticity of substitution	0.5	McKay and Wieland (2021)
$1-\lambda$	Required downpayment	0.2	McKay and Wieland (2021)
δ	Depreciation rate	0.017	McKay and Wieland (2021)
χ	Maintenance share	0.35	McKay and Wieland (2021)
ν	Operating cost	0.012	McKay and Wieland (2021)
ρ_y	Income persistence	0.977	Flodén and Lindé (2001)
σ_ϵ	Income shock std. dev.	0.058	Flodén and Lindé (2001)
$\overline{r}$	Real rate mean	0.0143	10-Year Treasury Rate: 1961-2024
ρ	Real rate persistence	0.979	10-Year Treasury Rate: 1961-2024
σ	Real rate shock std. dev.	0.0014	10-Year Treasury Rate: 1961-2024
τ_b	Borrowing spread	0.4156%	30-Year Fixed Mortgage Rate: 1971-2024

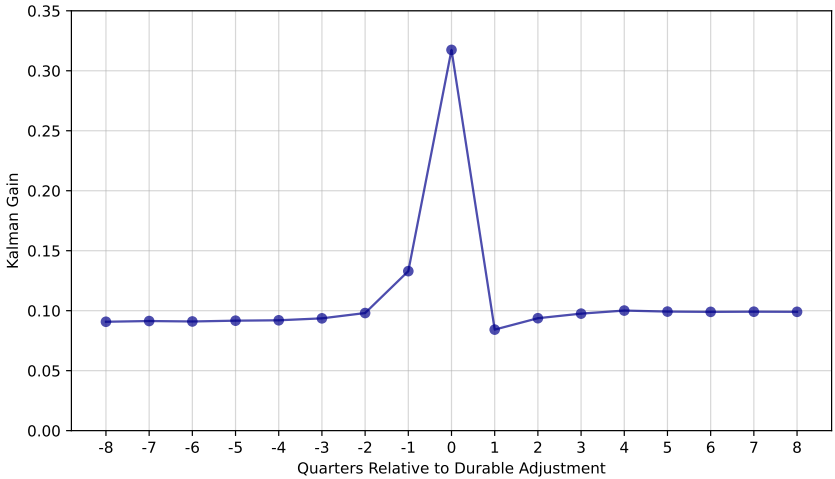
▸ Welfare Loss

Effect of Information Cost on Information Acquisition



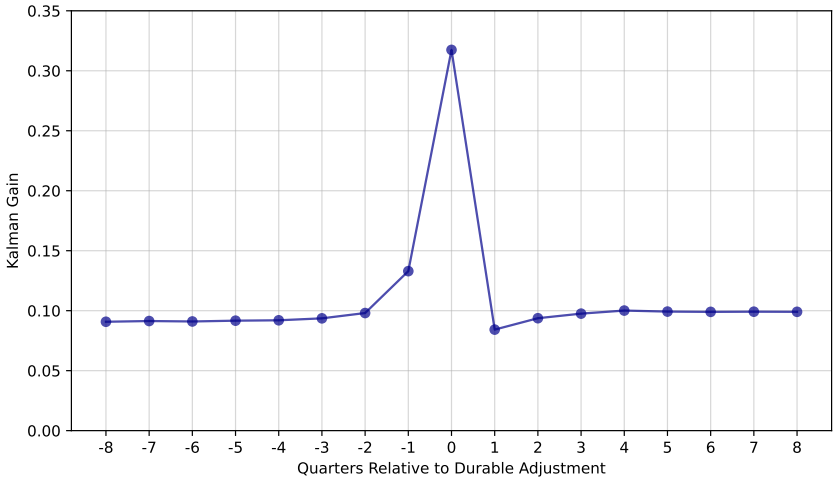
▸ Summary Stats ▸ Durables Adjustment Hazard

Information Acquisition in Event-Time



Households acquire information in **all** periods...

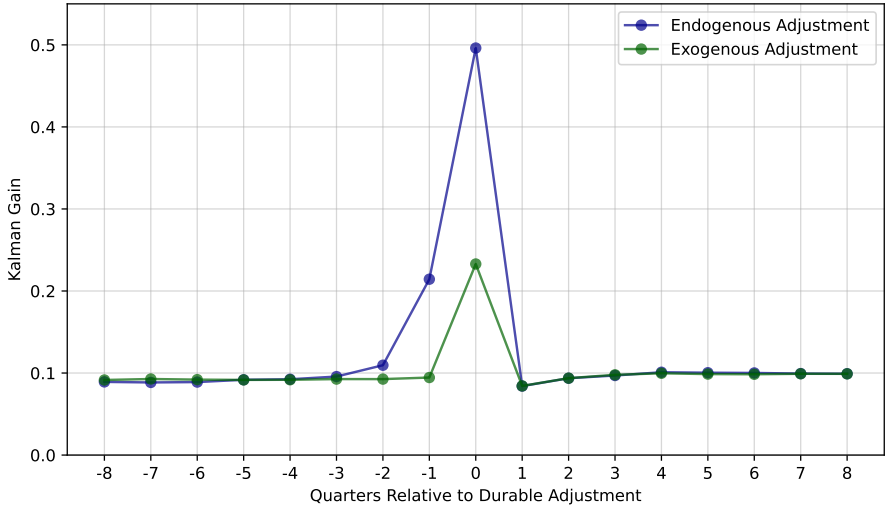
▸ Durables Share ▸ Information Acquisition sS ▸ Nowcasts



... but this information acquisition is **concentrated** around durables adjustments

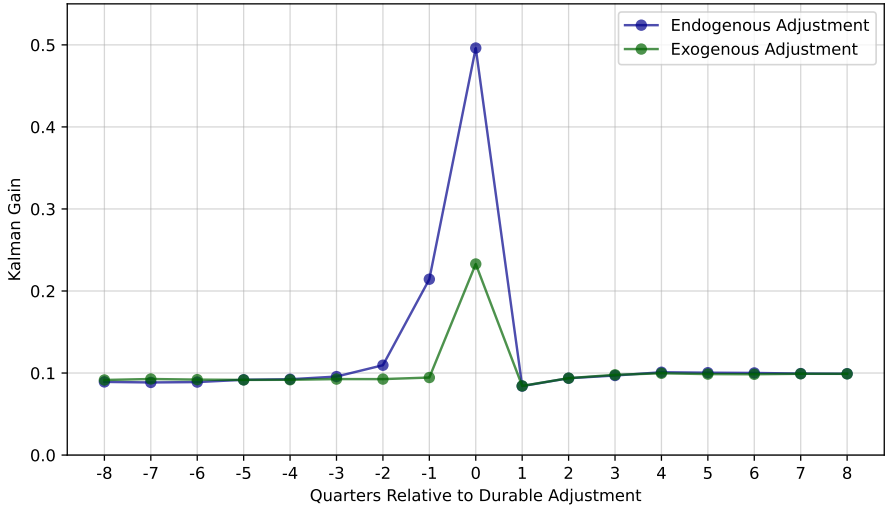
▸ Durables Share ▸ Information Acquisition sS ▸ Nowcasts

Endogenous Adjustments ⇒ Info. Acquisition Pre-Choice



Information acquisition increases in anticipation of **state-dependent** adjustments...

Endogenous Adjustments ⇒ Info. Acquisition Pre-Choice

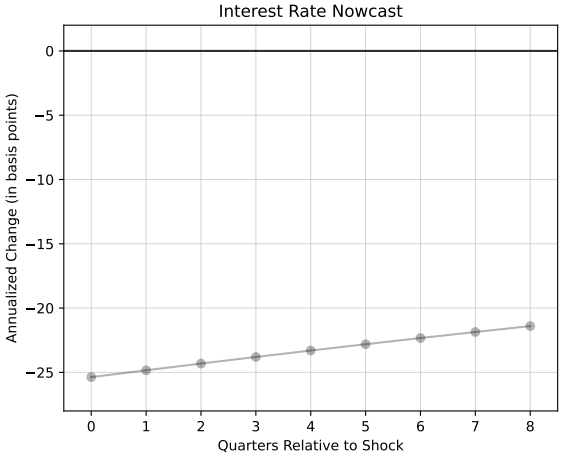


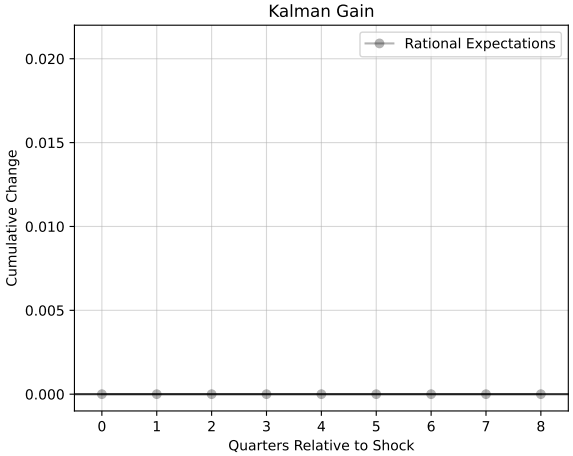
... but is concentrated around the choice for **time-dependent** adjustments Afrouzi et al. 24

Outline

Responses to Interest Rate Cuts

Impulse Response of Beliefs to Rate Cut

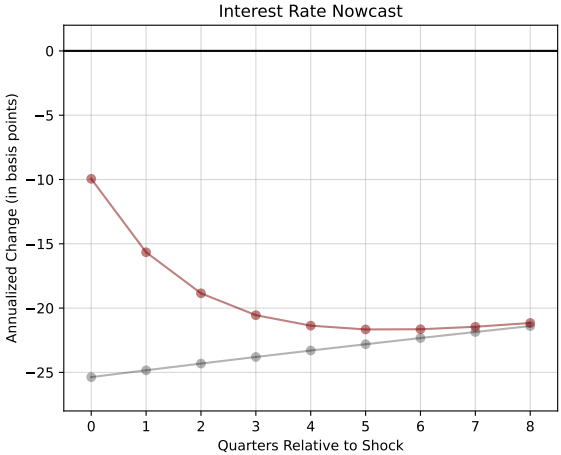


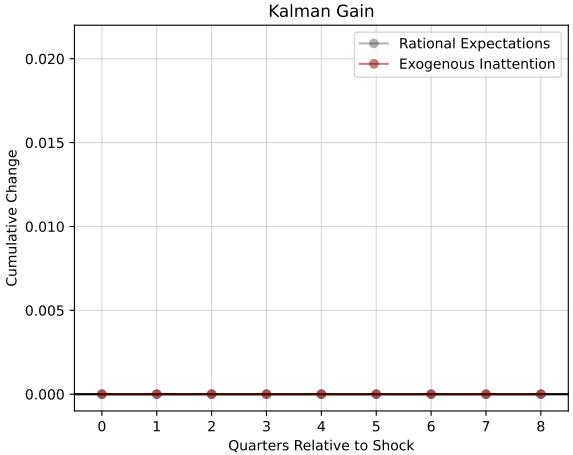


Rational expectations: households observe current interest rate

▸ Decomposition

Impulse Response of Beliefs to Rate Cut

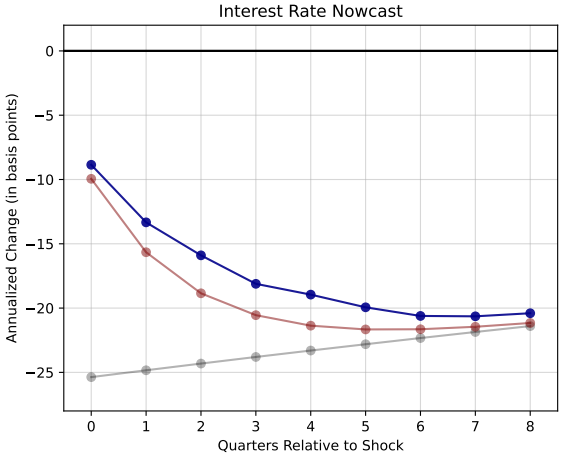


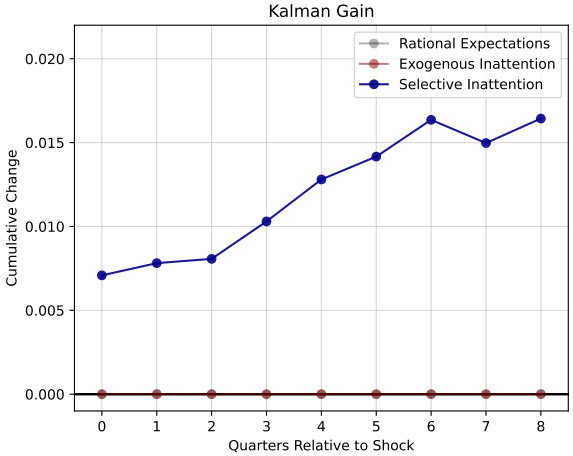


Exogenous inattention: constant G set to match CG 15 coefficient in baseline model

▸ Decomposition

Impulse Response of Beliefs to Rate Cut

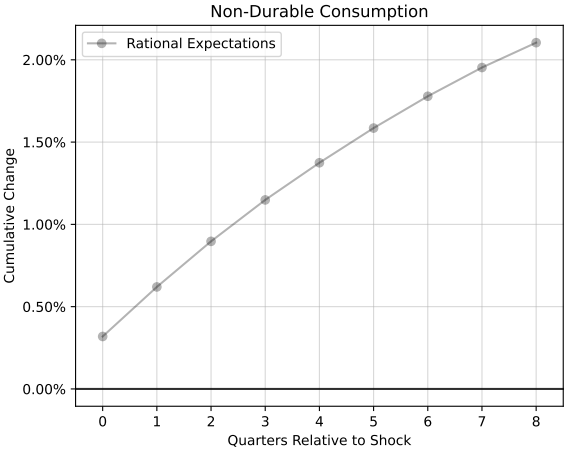


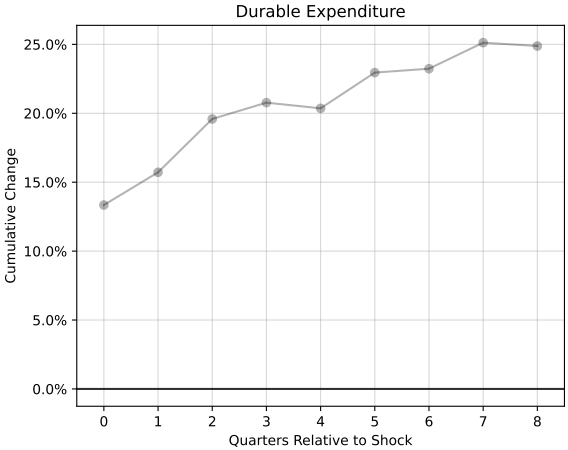


Selective inattention: baseline model with endogenous information acquisition

▸ Decomposition

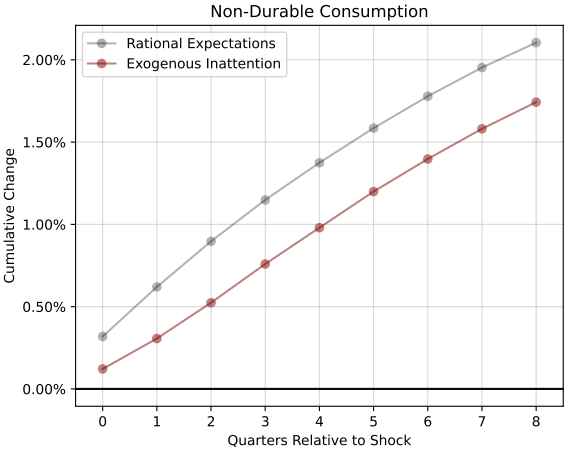
Impulse Response of Spending to Rate Cut

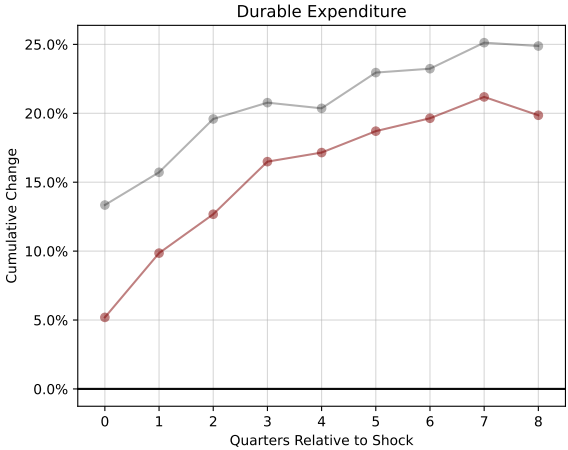




▸ Incorporating GE Effects ▸ Non-Linearity

Impulse Response of Spending to Rate Cut





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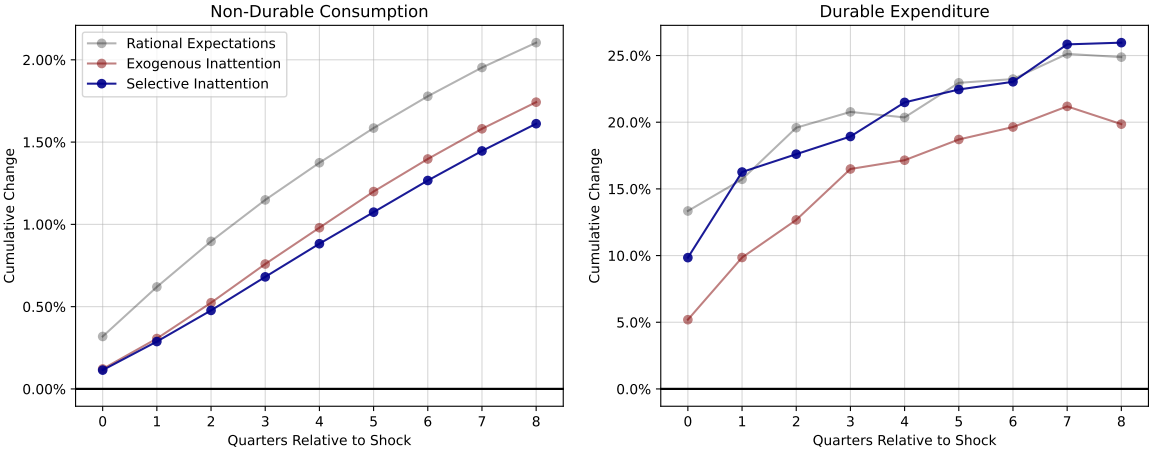

Non-durable response is dampened like with **exogenous inattention**...

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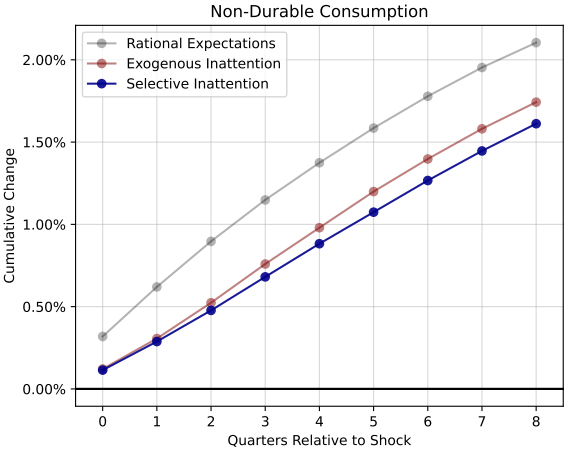
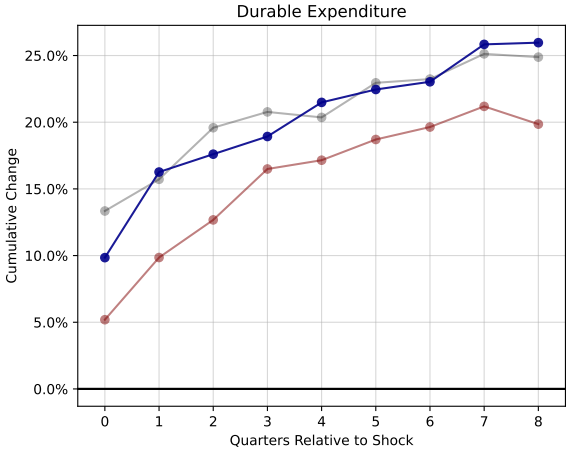
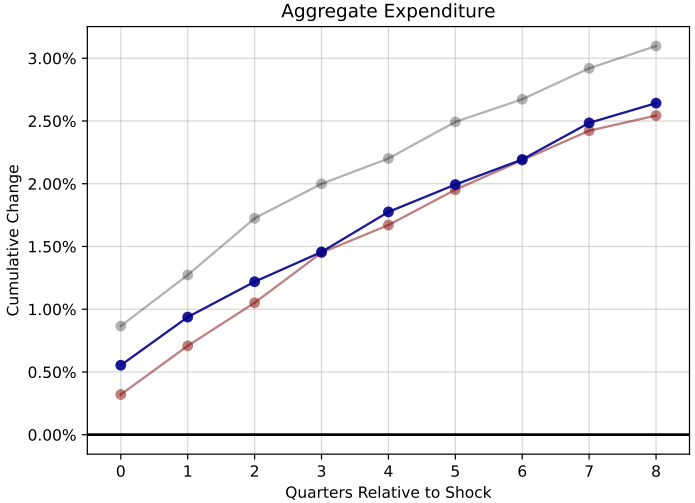




... but **durable** response is larger, closer to **rational expectations**!

▸ Incorporating GE Effects ▸ Non-Linearity

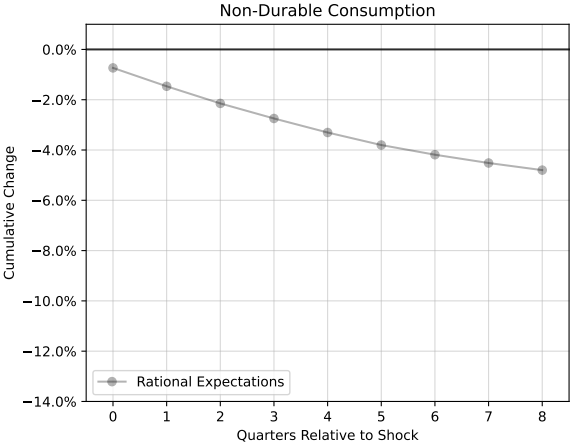
Small Difference in Aggregate Spending Response to Rate Cut

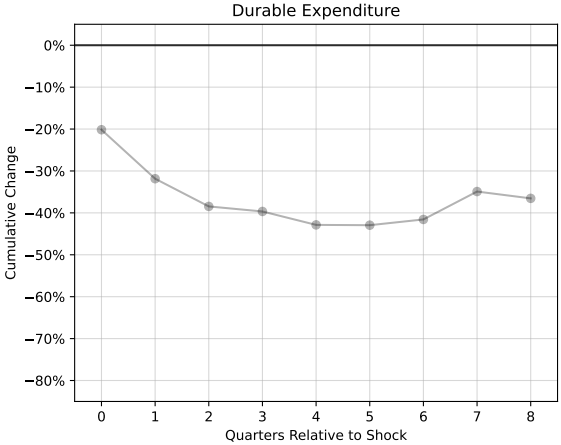


Shift in **composition** of spending to durables $\Rightarrow$ GE effects through $\frac{p_d}{p_c}$ Barsky et al. 07

Effects of Changes in Interest Rate Volatility

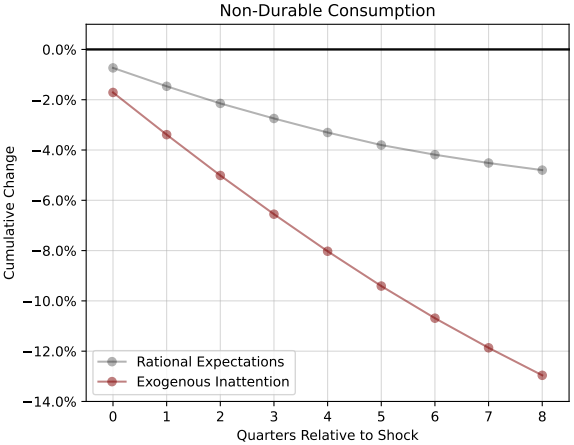
Impulse Response of Spending to Increase in Volatility

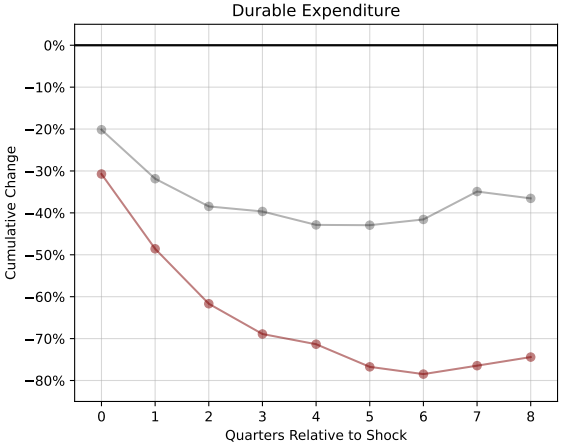




Increase in volatility $\Rightarrow$ spending falls due to precautionary motives...

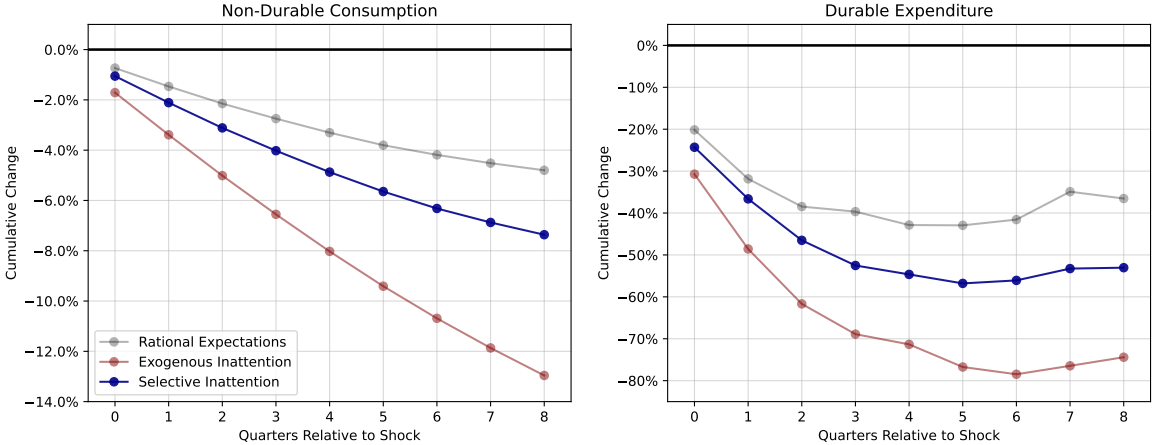
Impulse Response of Spending to Increase in Volatility





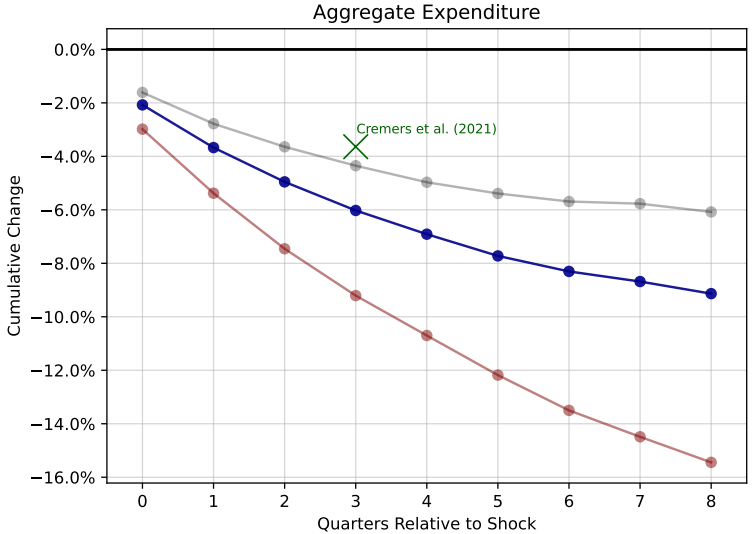
... which is stronger with **exogenous inattention** because of additional uncertainty

Impulse Response of Spending to Increase in Volatility



Selective inattention undoes over 50% of this fall due to ↑ info. acquisition!

Response of Aggregate Spending is Closer to the Data



▸ State-Dependence of Rate Cuts

Outline

Conclusion

- Data: Households are selectively inattentive to interest rates
  - IA is concentrated around durables purchases, where beliefs are more accurate
- Model: **Like** exogenous inattention, selective inattention generates:
  1. Slow-moving aggregate beliefs
  2. Dampened responses of non-durable consumption to interest rates

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  2. **Dampens** responses to changes in volatility closer to the data
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  4. **Reduces** state dependence of rate cuts on volatility (see paper)

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Takeaway: Right model of belief formation may be different for lumpy decisions, such as durables, price setting, investment, hiring and firing, ...

THANK YOU!

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Additional Results from New Survey

- Information acquisition (IA) is primarily about the current values of variables
- Primary source of information is internet search
- No difference in IA based on mortgage type or refinancing plans
- Positive effect of decision-making due to job relocations on IA
- IA is directly associated with belief accuracy and uncertainty
- Similar improvement in belief accuracy for home purchases to SCE
- Reductions in subjective uncertainty for home purchases

Survey Description

We design and conduct a cross-sectional survey of U.S. households via Prolific

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Survey Innovations

- Direct measure of distance from durable adjustments
  - Primary home purchase
  - Car purchases
- Measures of information acquisition other than forecasting performance
  - Last active search for information about key variables

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Main Blocks

1. Home decision-making: distance from primary home purchase

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Main Blocks

1. Home decision-making
2. Other decisions: distance from car purchase + other major financial decisions

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Main Blocks

1. Home decision-making
2. Other decisions
3. Information acquisition: time since last search + type/source of info searched

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Main Blocks

1. Home decision-making
2. Other decisions
3. Information acquisition
4. Macro expectations: beliefs about mortgage rates, T-Bill rates, and inflation

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We design and conduct a cross-sectional survey of U.S. households via Prolific

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  - Last active search for information about key variables

Main Blocks

1. Home decision-making
2. Other decisions
3. Information acquisition
4. Macro expectations
5. Background & financial situation: info on household's balance-sheet using SCF format, demographics, job relocations

Questions Back

Main Survey Questions

- Eliciting our main measure of information acquisition

  Step 1: *In the last 3 years, did you actively search for information about any of the following economic variables in the U.S.?*

  By "active search" we mean a deliberate effort to find information which could include searching online, reading news articles or reports, talking to a financial advisor or broker, or any other intentional effort to gather information.

  Step 2: *How many months ago did you last actively search for information about mortgage rates?*

- Eliciting households' distance from the primary home purchase

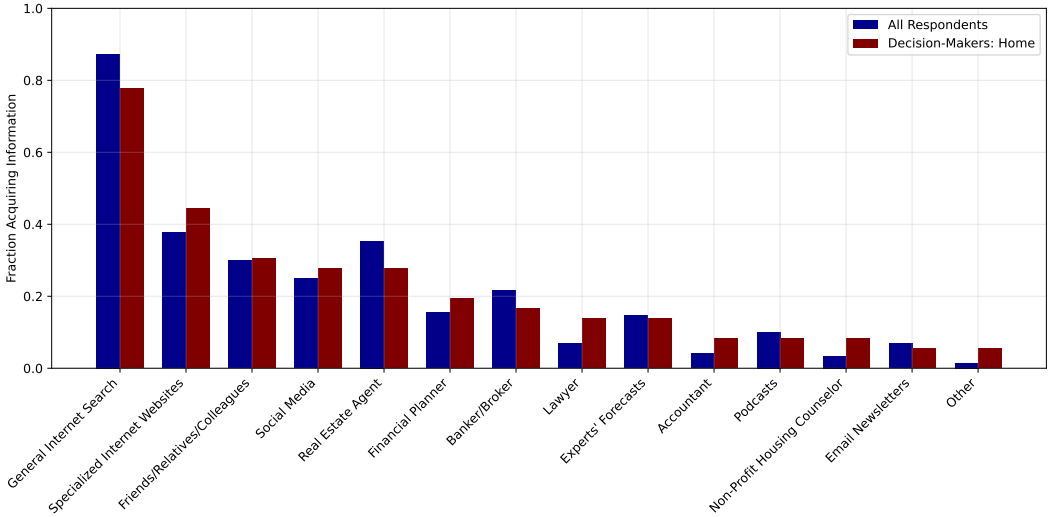
  Owners: *How many months ago did you finalize the purchase of your current primary residence?*

  Renters: *How many months from now do you expect the closing on your primary residence purchase?*

  By "closing", we mean signing the final documents to officialize the purchase.

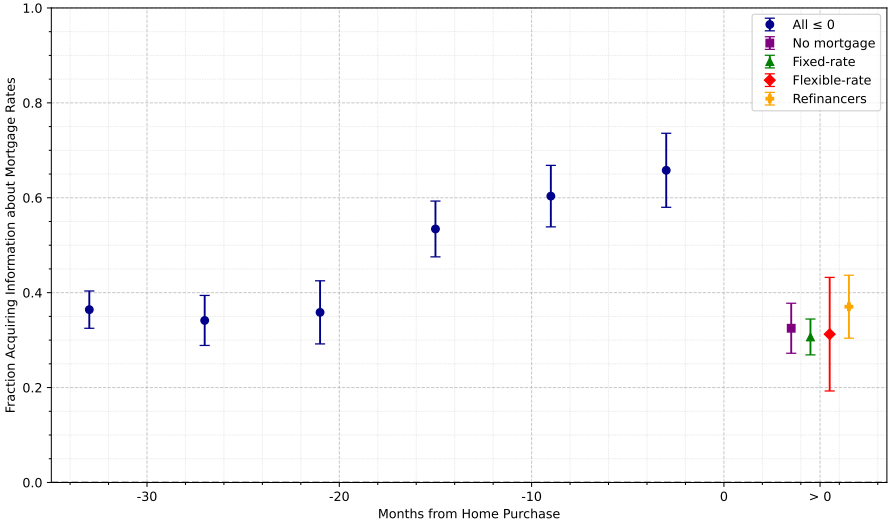
Back

Sources of Information Acquisition



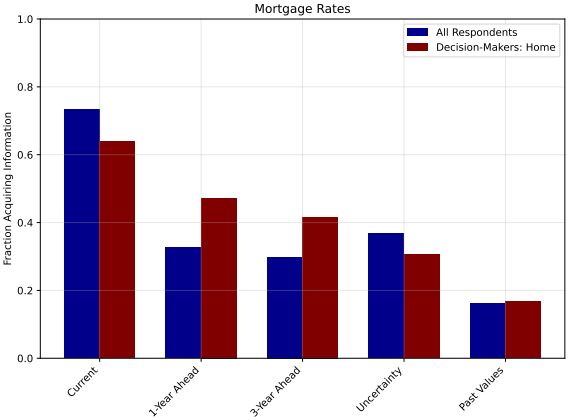
◂ Back: IA ◂ Back: Additional Results

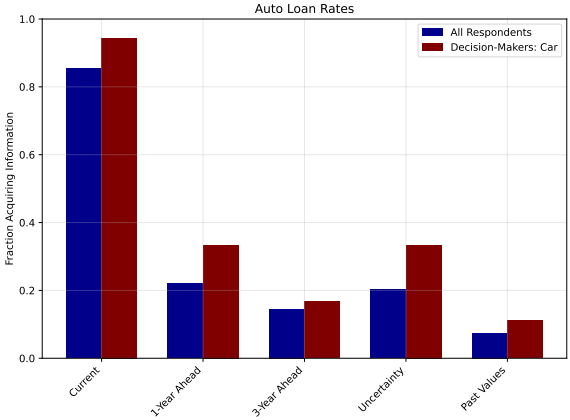
Heterogeneity in Information Acquisition of Owners



◂ Back: IA ◂ Back: Additional Results

IA is Primarily about Current Values of Variables





▸ Investment Decisions ◂ Back: IA ◂ Back: Additional Results

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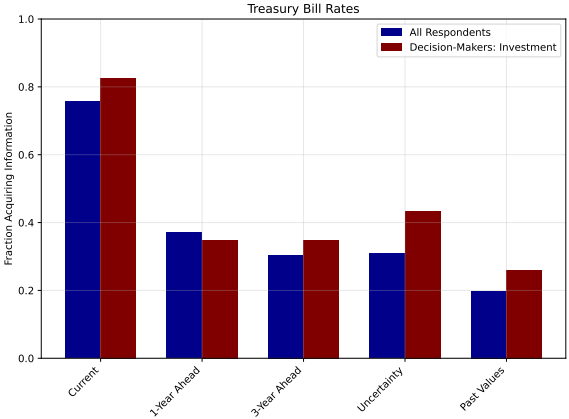


Back

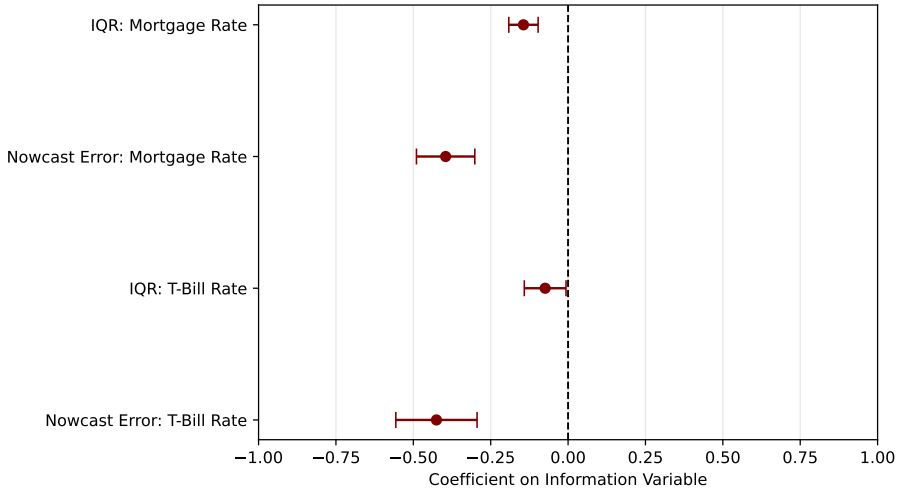
- Concern: decision-making is **endogenous** to information acquisition and beliefs
- Solution: **IV** = anticipated moves due to job relocations

Dependent Variable: Information Acquisition

Variable	OLS	First Stage	IV	OLS	First Stage	IV
Home Decision-Maker	0.30***		0.89***	0.30***		0.96***
	(0.07)		(0.34)	(0.06)		(0.34)
Job Relocation		0.23***			0.23***	
		(0.07)			(0.07)	
N	787	787	787	787	787	787
Controls				✓	✓	✓
F-stat		10.51			3.57	

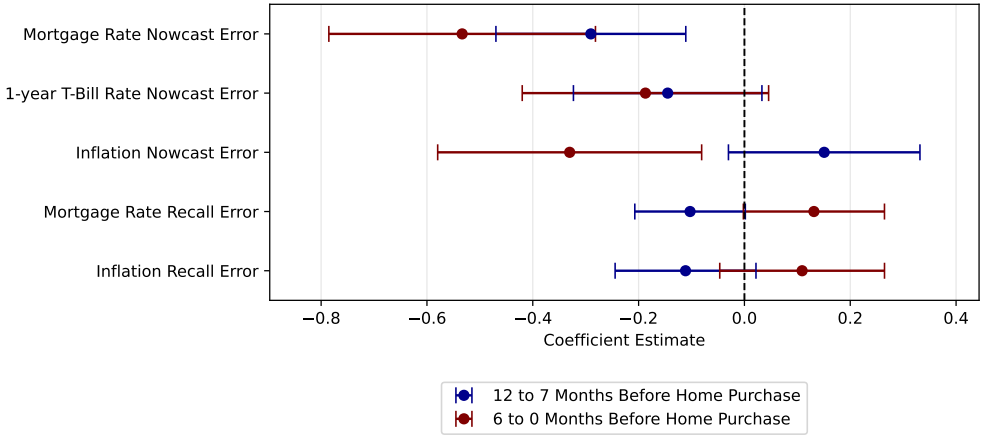
Back

Direct Association Between IA and Beliefs



Back

Reduction in Nowcast Errors: Home Purchase



Back

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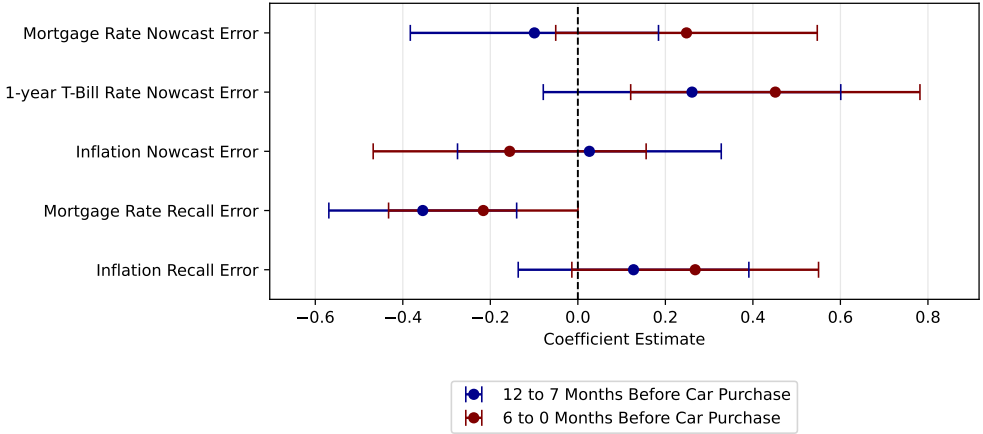
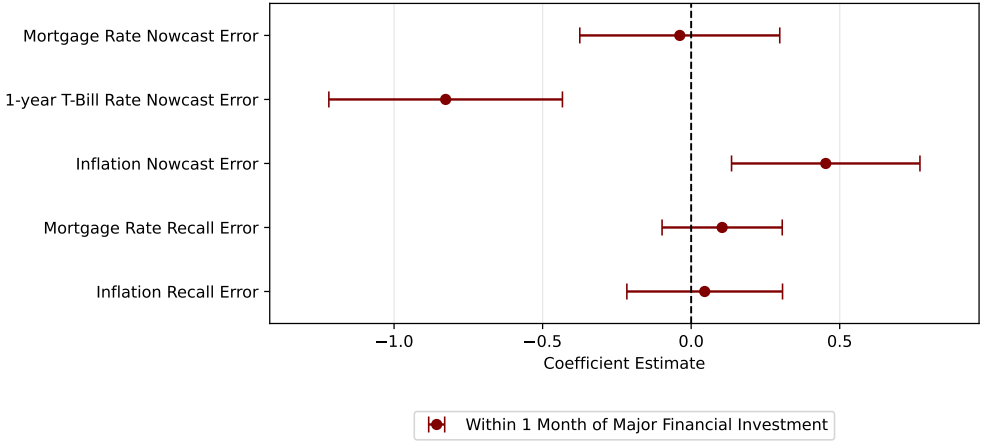


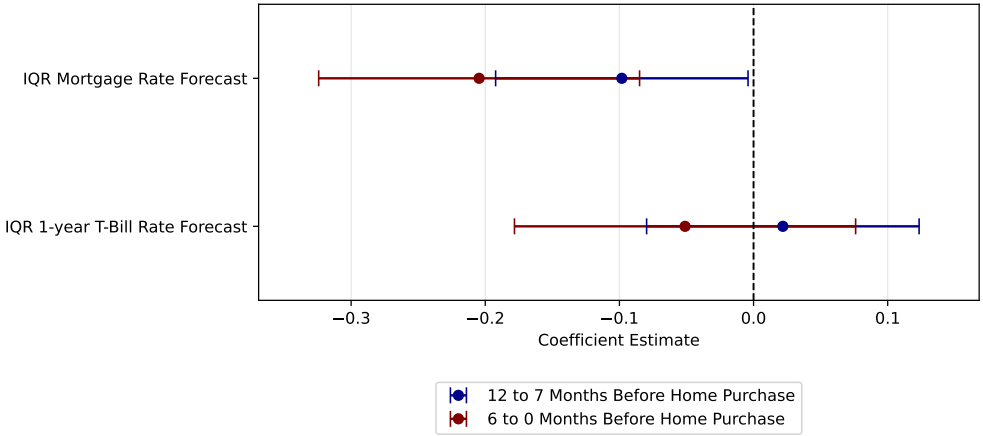
Back

Reduction in Nowcast Errors: Financial Investment



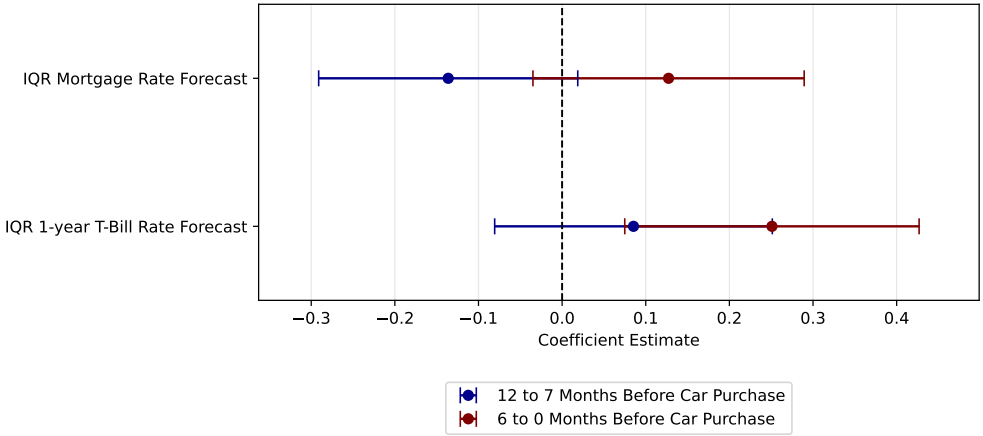
Back

Reduction in Subjective Uncertainty: Home Purchase



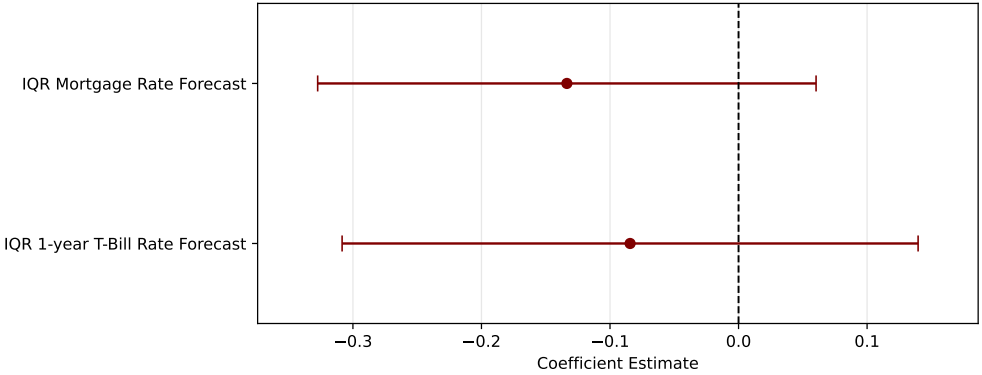
Back

Reduction in Subjective Uncertainty: Car Purchase



Back

Reduction in Subjective Uncertainty: Financial Investment



Back

Welfare Loss from Inattention

- Natural question: how large are welfare losses from selective inattention?
- Compute two welfare metrics in **basis points** of lifetime consumption
  1. **Static**: loss from not having full-information in **current** period, ignoring info. cost
  2. **Dynamic**: loss from not having full-information in **all** periods, ignoring info. cost

◂ Back: Calibration ◂ Back: CG

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  2. **Dynamic**: loss from not having full-information in **all** periods, ignoring info. cost
- Losses are **small**, but still have aggregate effects! Akerlof-Yellen 85 Maćkowiak-Wiederholt 15

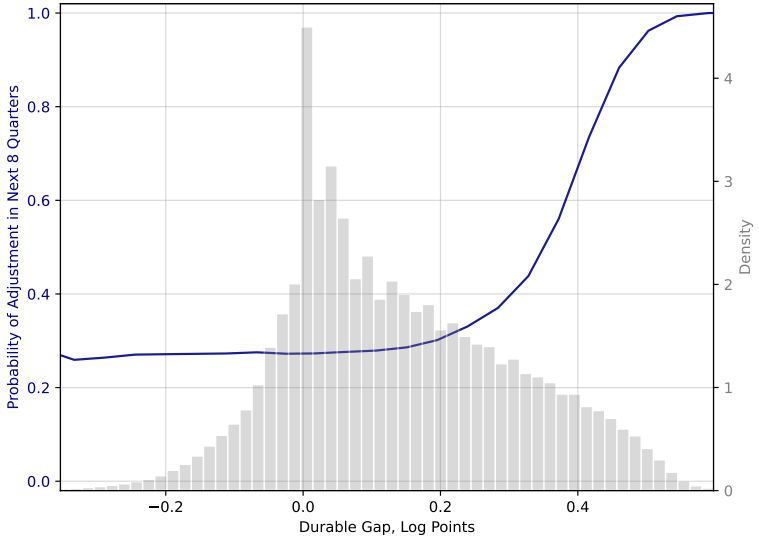
	Static	Dynamic
Mean	0.03	2.17
Median	0.02	1.9

◂ Back: Calibration ◂ Back: CG

	Mean	SD	P10	P50	P90
Assets/Income: b/y	3.51	4.93	-0.91	1.91	10.27
Durable/Non-Durables: d'/c	2.55	0.40	1.99	2.58	3.01
Durables Gap	0.14	0.17	-0.05	0.11	0.38
Acquired Information	0.23	0.42	0.00	0.00	1.00
Kalman Gain: G	0.10	0.21	0.00	0.00	0.40
Kalman Gain Conditional on IA	0.46	0.21	0.30	0.40	0.80
Normalized Nowcast Error: $\lvert\hat{\mathbb{E}}(r) - r\rvert/\lvert r\rvert$	0.28	8.00	0.02	0.10	0.32
Normalized Prior Variance: Σ/σ_r^2	0.33	0.17	0.13	0.30	0.57

Back

Adjustment Probability as a Function of Durables Gap



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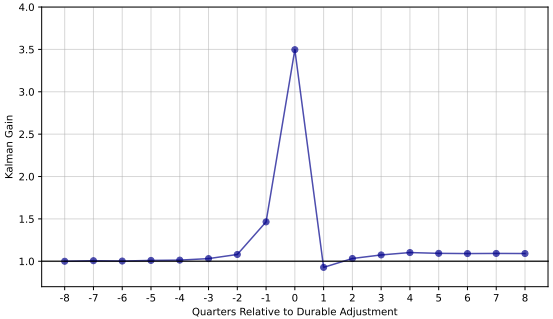
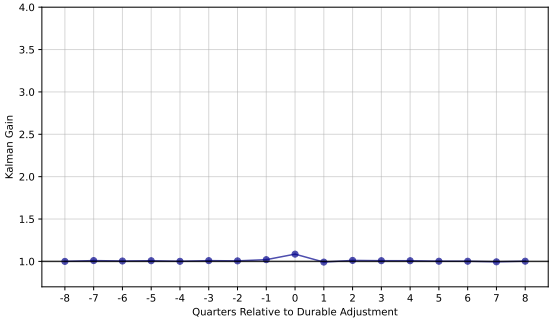
Baseline: $\psi = 0.63$

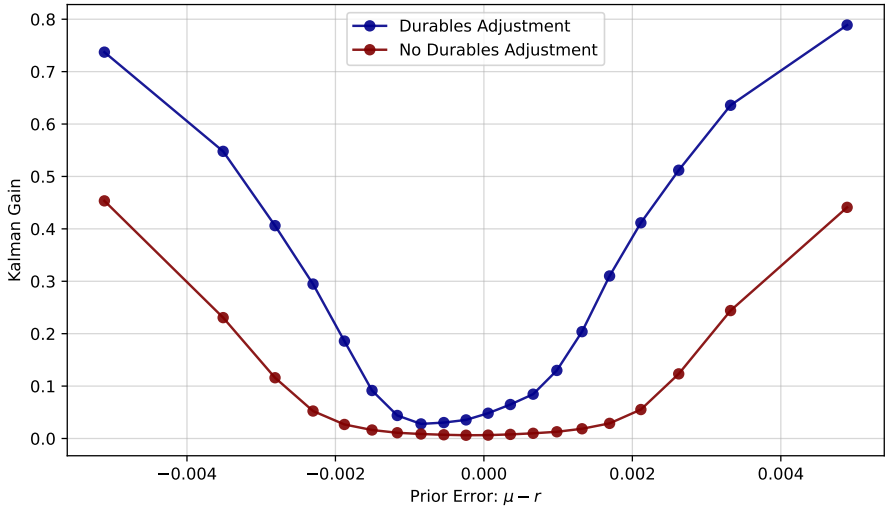


Low Durables Share: $\psi = 0.99$



Back

Durables Adjustment Shift sS Bands of Info. Acqusition



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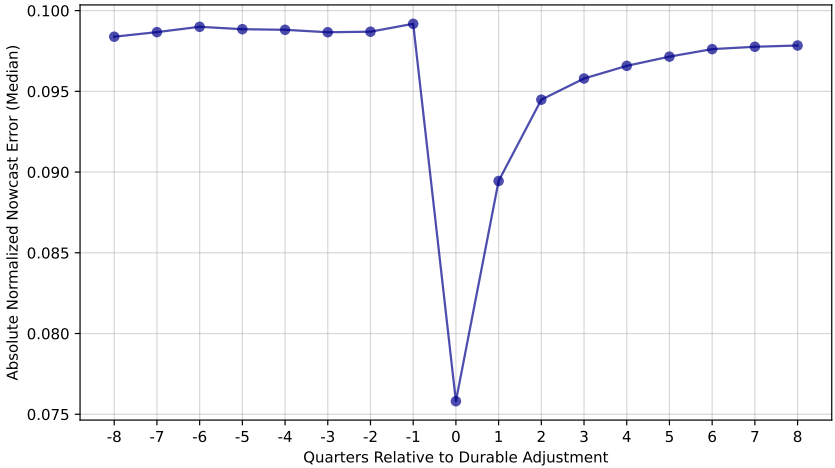
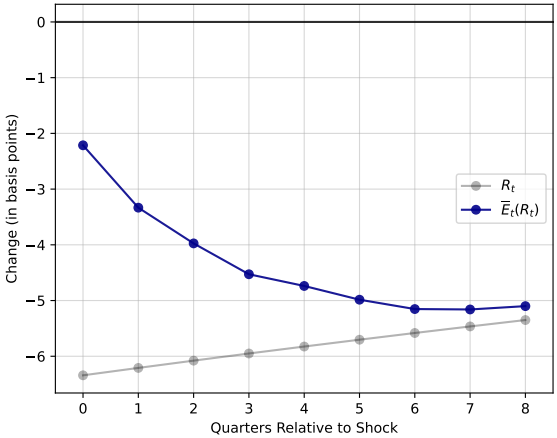
NOWCAST ERRORS IN EVENT-TIME

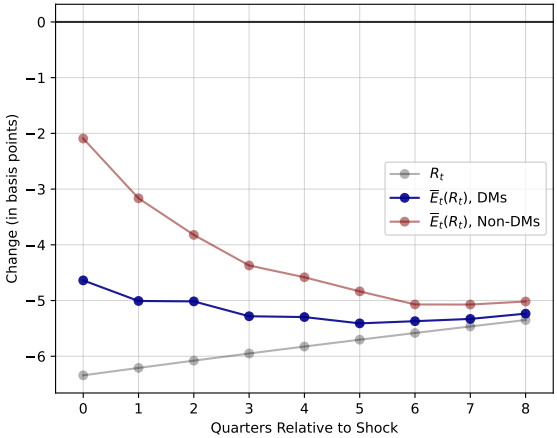


Forecast errors remain lower **post-choice** because beliefs are a “stock” not “flow”

Back

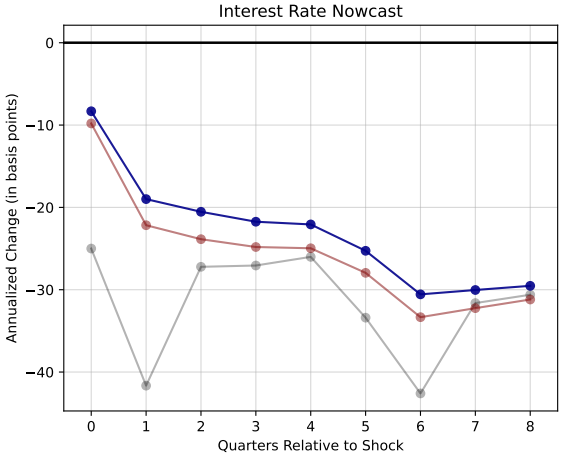
Decomposition of Aggregate Belief Response

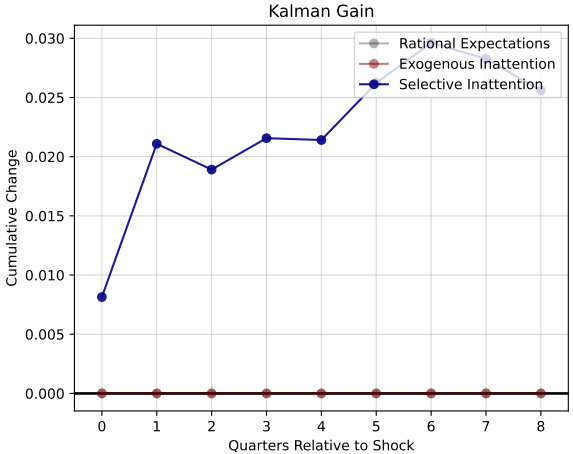




Back

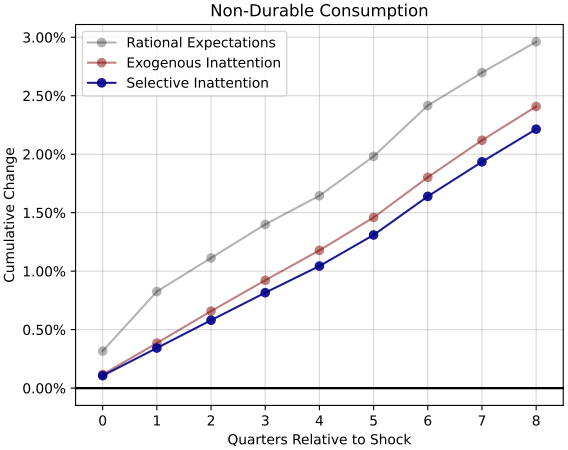
IRFs to Romer-Romer Shock with Agg. Y and P Response

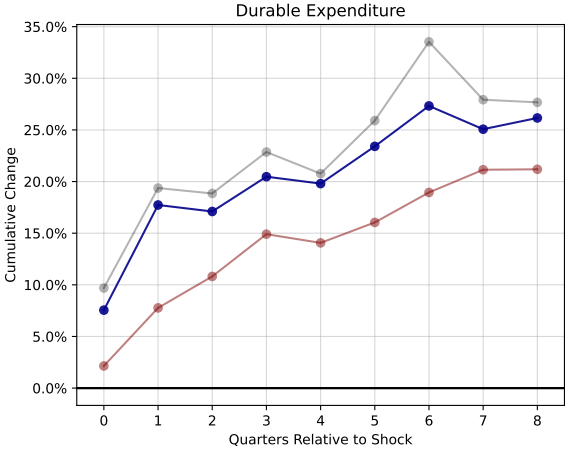




Back

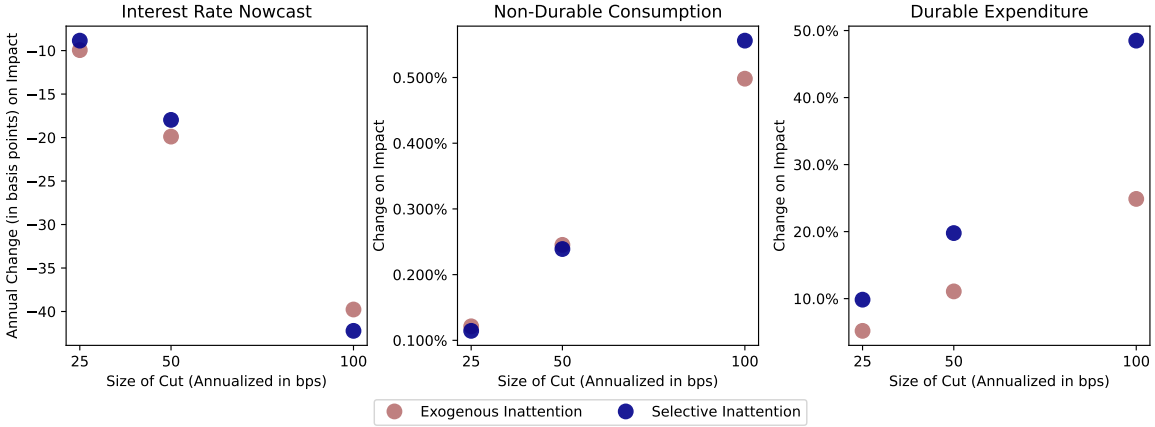
IRFs to Romer-Romer Shock with Agg. Y and P Response





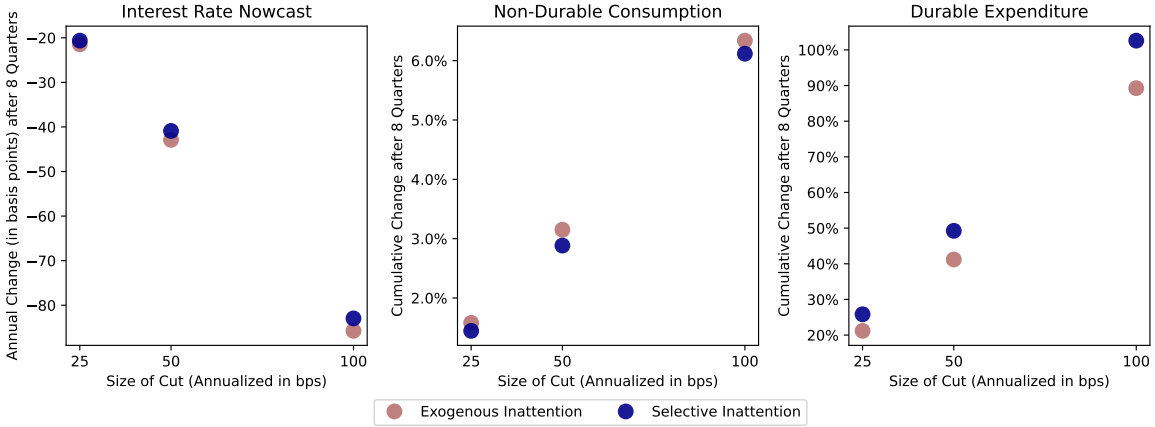
Back

Non-Linear Impact of Rate Cuts: On Impact



Back

Non-Linear Impact of Rate Cuts: After 8 Quarters



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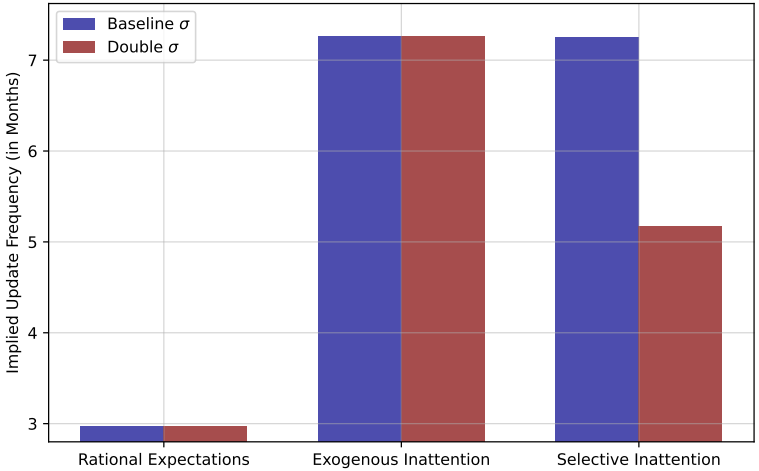
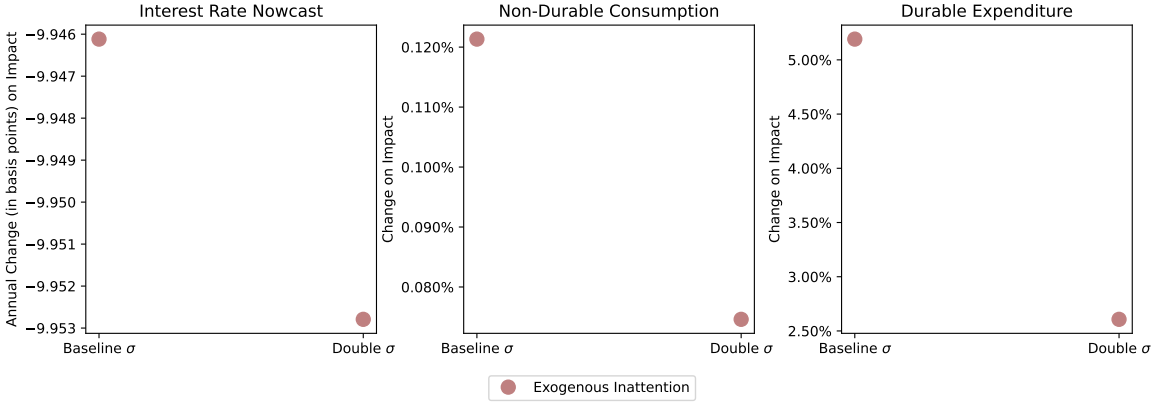
Effects of Increase in Volatility on Beliefs



Increase in volatility $\Rightarrow$ more information acquisition $\Rightarrow$ **less** belief rigidity

Back

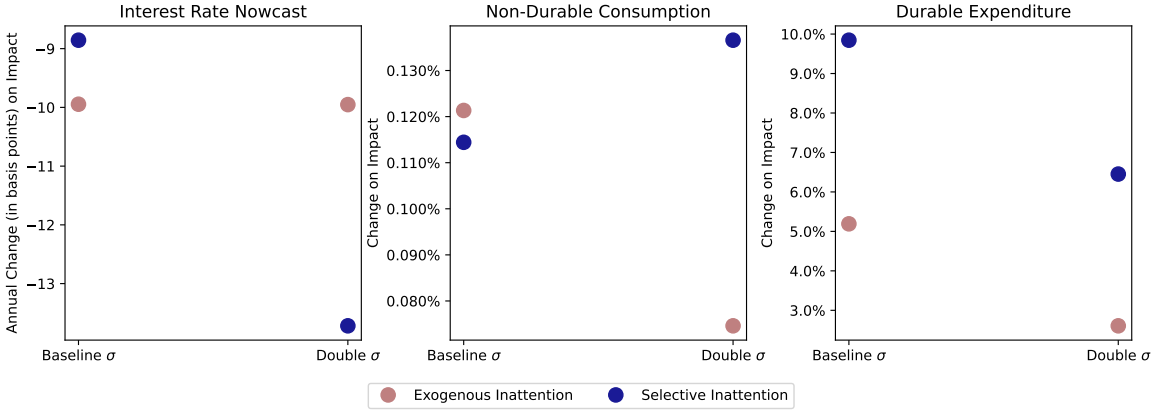
State-Dependence on Volatility: On Impact



Increase in volatility $\Rightarrow$ consumption is less responsive to interest rates

Back

State-Dependence on Volatility: On Impact



... but not with **selective inattention** because of increased info. acquisition!

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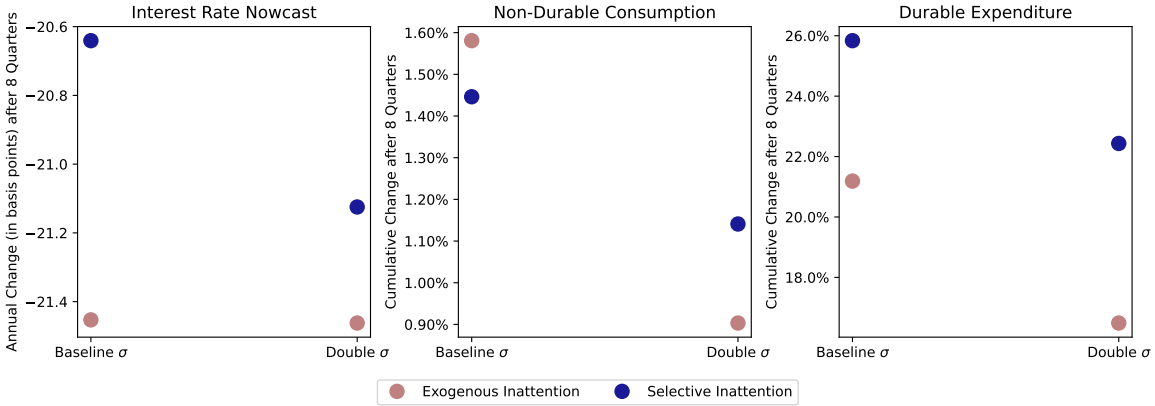
State-Dependence on Volatility: After 8 Quarters



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