Inflation Expectations and Behavior: Do Survey Respondents Act on their Beliefs?
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Discussion by
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New York, November 18, 2010
1. Summary of paper

Research questions:

1. Do individual consumers act on their beliefs about future inflation?
2. How informative are the inflation expectations elicited with surveys about the respondents’ true beliefs?

- focus on **individual consumers** rather than other agents (e.g. professional forecasters, financial market experts)
- use of **direct measurement** of inflation expectations (via survey questions) & financially incentivized investment **experiment**
  
  ↓

  - investment A whose outcome depends on rate of inflation
  - investment B whose outcome does not depend on rate of inflation
1. Summary of the paper

**Objects:**
- Price of things I usually spend money on
- Rate of inflation

**Time horizons:**
- From now and 12 months from now
- Btw 24 and 36 months from now

**Measures:**
- Point predictions
- Probabilistic beliefs → “Estimated expected prediction” and “Estimated std.dev. of prediction”
1. Summary of the paper

Treatments:
- Survey treatment
  - Price in general
  - Rate of inflation
- Experimental treatment
  - Ascending scale earnings
  - Descending scale earnings

Models:
- Switching point btw investment A and B → Research question 1
- Minimum distance from risk neutrality → Research question 2
2. Main findings

Switching point analysis:

- No treatment effect
- Consistent with theory, there is a generally monotonic decreasing relationship between the reported price/inflation beliefs and the switching point
- Strong relationship between a respondent’s price/inflation point prediction and his/her switching point
- All else equal, more risk averse subjects have lower switching point, while more risk loving subjects have higher switching point
- Respondents with more diffuse beliefs tend to switch investment earlier
- Neither the measure of numeracy and financial literacy, nor the time taken by respondents to complete the survey seems to have explanatory power

⇒ Evidence of relationship btw stated beliefs and actions, on average
2. Main findings

Min. distance from risk neutrality analysis:

- Strong positive relationship between the self reported distance from risk neutrality and the distance from the risk neutral choice.
- Inconsistent with theory, additional parameters are significantly different from zero.
- Both the measure of numeracy and financial literacy, and the time taken by respondents to complete the survey seems to have explanatory power.

⇒ Evidence of high degree of heterogeneity across individuals, explained by risk aversion and optimization errors.
3. Comments

Subjective SAS risk aversion and Table 4 results

- 1 to 7 scale - from very risk averse to very risk loving - 4 = risk neutrality
- but.. is 4 really risk neutrality or a proxy for “I do not really know?”
- do you give the possibility of Do not know answers?
- what about focal points?
- worth trying defining risk neutral those reporting answers 3 & 5 and dropping answer 4?
- alternative measures of risk aversion? more objective? e.g. share of risky assets in their portfolio?
3. Comments

**Heterogeneity across individuals**
- In line with Ehrmann et al. (2010): disagreement among professional forecasters
- Away from the “representative agent” model
  - What are the consequences for a CB?
  - Is this a good/bad thing?
  - Can this potentially lessen the ability of CB to manage inflation expectations?

**Price in general vs Rate of inflation**
- How do the two measures correlate with each other?
- Ex-post: can you say whether one is better perceived than the other?
3. Comments

Very relevant topic!

Monetary policy

- Svensson (2004): Monetary policy is to a large extent the management of expectations
- Woodford (2003): Not only do expectations about policy matter, but, at least under current conditions, very little else matters
- Bini Smaghi (2005): Inflation is the “Enemy n. 1” of central bankers

CB communication

- Bernake (2005): A more transparent policy process increases democratic accountability, ..., reduces uncertainty in financial markets, and helps to anchor the public’s expectations of long-run inflations, which promotes economic growth and stability
- Can your paper (or potential extensions of it) contribute to this literature?