

# Average Inflation Targeting and Household Expectations

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**Third Behavioral Macroeconomics Workshop**

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# Motivation

- ▶ Over the last two years major central banks have undergone a strategy review.
- ▶ On August 27, Jerome Powell announced that the Federal Reserve was adopting a "flexible form of average inflation targeting".
- ▶ The question though is how effectively has that announcement been transmitted to households expectations.

# What do we know thus far

- ▶ During periods of low interest rates, say ELB, standard NK models predict that AIT does better in terms of boosting economic activity than IT.
- ▶ Households expect the CB to allow for higher inflation (overshooting) in the medium-run which in turn leads to lower expected real rates.
- ▶ Households thus expect a rise in the PV of their wealth and hence raise their consumption. So, the economy can escape the ELB at an earlier stage.

# The methodology

- ▶ Daily survey of consumers sponsored by Cleveland Fed, since March 2020.
- ▶ Given the focus on the announcements at the Jackson Hole meeting, another round of questions have been introduced.
- ▶ The additional questions were centered around the announcement date, August 27.
- ▶ Those questions vary from whether respondents have heard the news, to the means, the timing, to what was the main news about, to whom it was about.
- ▶ Importantly, respondents' understanding of Fed's targets as well as its imminent response conditional on a hypothetical path of inflation has also been assessed.
- ▶ Use of Randomized controlled trial (RCT) which allows us to escape the issue of news not reaching out households in an efficient way.

# First key question: Did they hear about it?

- ▶ Did they hear the news the day before, the day of the announcement and the day after?
- ▶ The higher fraction occurs the day after the announcement.
- ▶ The majority heard no MP news. No evidence of a strong intensive margin.
- ▶ All in all, Fed's announcement of a new strategy heard by a small fraction of the U.S. population.

## Second key question: How did the policy announcement shape the beliefs of those who heard it?

- ▶ Starting from the NK view.
- ▶ Questions characterizing respondents' understanding of MP.
- ▶ Absence of strong effects on the perceived objectives and strategies of the Fed, on average.
- ▶ Absence of understanding of a switch to AIT.
- ▶ No identification issues; little was known prior to August 27.
- ▶ Negligible effect of announcements on respondents' understanding of MP objectives and strategies.
- ▶ Striking result; People really don't understand MP, or maybe communication has been too bad.
  - ▶ AIT believers' expectations for inflation not far from those of IT believers'.

# Is AIT likely to significantly influence HH's expectations?

- ▶ Little evidence of NK mechanism.
- ▶ Respondents' reactions cast doubts on the effectiveness of AIT.

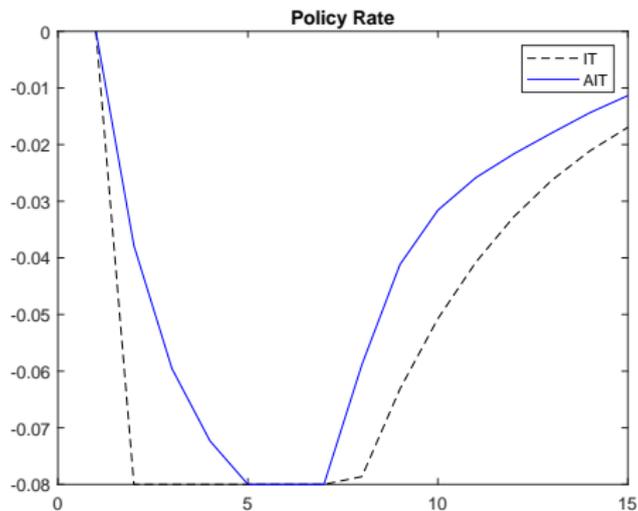
# Some thoughts

- ▶ Understanding of the announcement; I think it is maybe too early to judge. Don't forget about potential outside lag.
- ▶ But if it is true, what can we infer about the quality of the communication from the the Fed?
- ▶ AIT beliefs vs IT beliefs; apart from outside lag, one needs to distinguish between a change in the regime and understanding the implied dynamics in a specific regime. People have way more knowledge about what IT means or implies.
- ▶ Another important aspect is what the announcement is about; it could very well be that announcements of that sort attract little attention compared to announcements during a crisis (e.g. "whatever it takes"). So, conditioning on the regime where the announcement is made seems to be crucial. This relates to the level of understanding of MP.

# Some thoughts

- ▶ The authors relate their contribution to Angeletos et al. (2020). Angeletos et al. relates to uncertainty about the fundamentals and their inherent persistence. The current analysis is more about understanding or incorporating a MP announcement into expectations and not about the fundamentals.
- ▶ This paper more related to agents' understanding of MP or the interaction between their planning horizon and that implied by a specific MP.
- ▶ AIT requires that agent has a rather longer planning horizon than what IT does.
- ▶ One way to see that is to take a NK model with some heavier discounting. One candidate is the Blanchard-Yaari structure.
- ▶ I would thus find extremely interesting if the survey included some questions that could allow us to infer something about the average planning horizon of the respondents.

# Some off-the-shelf experiments



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