RESEARCH BRIEF • JULY 2023

Tell Me Something I Don't Already Know: Learning in Low and High-Inflation Settings

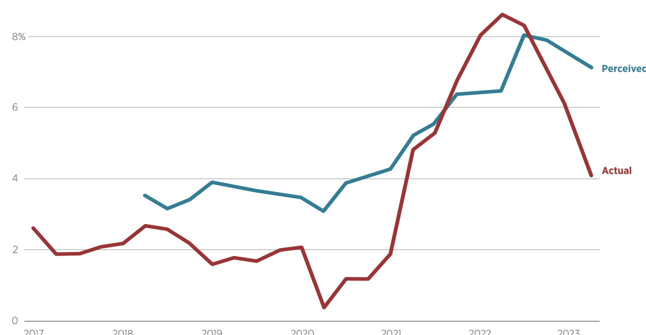
Based on BFI Working Paper No. 2023-102, "Tell Me Something I Don't Already Know: Learning in Low and High-Inflation Settings," by Michael Weber, University of Chicago; Bernardo Candia, UC Berkeley; Tiziano Ropele, Bank of Italy; Rodrigo Lluberas, Universidad ORT Uruguay; Serafin Frache, Universidad de Montevideo; Brent H. Meyer, Federal Reserve Bank of Atlanta; Saten Kumar, Auckland University of Technology; Yuriy Gorodnichenko, UC Berkeley; Dimitris Georgarakos, European Central Bank; Olivier Coibion, UT Austin; Geoff Kenny, European Central Bank; and Jorge Ponce, Banco Central del Uruguay

As inflation has recently risen in advanced economies, both households and firms have become more attentive and informed about inflation, leading them to respond less to information about inflation and monetary policy.

The environment in which we live shapes our behavior and beliefs. Those who grew up during the Great Depression, for example, tend to be more wary of financial risk.[1] Those who lived through hyperinflation are similarly scarred by the experience and are less likely to invest in risky assets.[2] While the effects of historical episodes on behavior can be studied ex-post, it is more challenging—but of paramount importance for policymaking—to study how the peoples' beliefs evolve in real time. In this paper, the authors study how changing inflation alters the learning process of individuals.

The authors use evidence from a set of randomized controlled trials (RCTs) in which some individuals were provided with publicly available information about inflation, such as recent inflation rates or the central bank's target. The authors assess whether, when provided with this information, individuals tend to adjust their expectations. They take large adjustments to mean that individuals were otherwise inattentive to inflation.

Figure 1 • Inflation, Actual vs. Perceived



Note: This figure plots the perceived inflation rates of US households (measured using the Nielsen survey) against actual inflation. As you can see, households significantly overestimate inflation when inflation rates are low, but as inflation rises perceptions get very close to actual levels of inflation.

A key challenge in this approach is unifying results from multiple RCTs, which take place

[1] Malmendier, Ulrike, and Stefan Nagel, 2011. "Depression Babies: Do Macroeconomic Experiences Affect Risk Taking?" *Quarterly Journal of Economics* 126(1): 373-416.

[2] Fajardo, Jose, and Manuela Dantas, 2018. "Understanding the impact of severe hyperinflation experience on current household investment behavior," *Journal of Behavioral and Experimental Finance* 17(March): 60-67.

at different times and in different countries. To ensure that any changes in peoples' expectations are attributable to actual changes in their attention versus the many factors that inherently vary across countries, the authors observe the changing effects of RCTs within each country, over time. They follow this approach for nationally representative samples of households in the US (from the Nielsen Homescan Panel), euro-area households (from the European Central Bank's Consumer Expectations Survey), and US firms (from Atlanta Fed's Business Inflation Expectations survey). They also validate their analysis using RCTs covering nationally representative samples from Uruguay, New Zealand, and Italy.

The authors find that **as inflation has increased to historically high levels in the past few years, households and firms in the United States and the euro area have become more informed about rising prices and therefore less responsive to information treatments involving information about inflation.**

The upshot is that when inflation is higher, households and firms pay more attention. This result has important implications for policy. When agents are less attentive, the relationship between employment and inflation loosens,[3] forward guidance is less powerful,[4] and there is a greater risk of facing a liquidity trap.[5] Each of these mechanisms is central to monetary policy decisions, and studying how attention varies across settings should therefore be an important objective for future work.

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[3] Afrouzi, Hassan, and Choongryul Yang, 2021. "Dynamic Rational Inattention and the Phillips Curve," Manuscript.

[4] Kiley, Michael, 2021. "Policy Paradoxes in the New Keynesian Model," FEDS Working Paper No. 2014-29.

[5] Pfauti, Oliver, 2023. "Inflation – Who Cares? Monetary Policy in Times of Low Attention," Manuscript.

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