

Discussion of 'Economic literacy and inflation expectations: evidence from an economic experiment'

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Summary

- ▶ The authors present evidence from an experiment designed to elicit subjects' beliefs about which data are important for forming inflation expectations and to observe how given data are used in the formation process in a simulated economy.
- ▶ Results suggest that economic and financial literacy is important for explaining differences in forecasts between subjects, where literacy is associated with both differences in the knowledge about which data to use and different uses of the data provided when forming inflation expectations.

Summary cont'd

- ▶ Economically more literate subjects had lower and more accurate perceptions of actual U.S. inflation and also lower expectations of future U.S. inflation.
- ▶ In simulated exercises, economic literacy was the dominating effect explaining higher forecast accuracy, as more literate subjects were more likely to choose relevant information and made better forecasts given a fixed set of information.
- ▶ Demographic and socioeconomic differences in inflation forecasting can be largely explained by differences in economic literacy. Some significant effects of demographics on forecast accuracy in the endogenous exercises suggest that differences arise from different selection of information.

Discussion of the Results

- ▶ Table 6 - Explaining ME, % Overestimated & MAE:
 - ▶ Mean errors give the average tendency to over-/underestimate inflation. Before averaging forecast errors across individuals, it might be useful to weigh them with the inflation rate of the simulated exercise, since a high rate of inflation is likely to induce a less accurate forecast.
 - ▶ The effect of large forecast errors can also be analyzed by comparing models explaining mean absolute errors and root mean squared errors.
 - ▶ What is the estimation method for the models explaining „% Overestimated“ and how is the categorical variable constructed?

Discussion of the Results

- ▶ Table 7 - Choice Rate of Inflation:
 - ▶ How is the choice rate constructed? What is the estimation method? Maybe use an (multinomial) logit model to compare the probability of choosing inflation across exercises.
 - ▶ All demographic factors explaining the choice rate of „current and recent inflation“ as information source remain significant when the literacy score is included!
 - ▶ ⇒ Literacy plays a role for the use of relevant information, but other factors (age, race, income and education) are important as well.

Discussion of the Results cont'd

- ▶ Table 8 - MAE between exogenous & endogenous exercises:
 - ▶ Are coefficients on „Black“ and on „Literacy Score“ significantly different across exogenous and endogenous exercises?
 - ▶ What is the intuition for the effect of low and high incomes on reducing mean absolute errors in the exogenous exercises?
- ▶ General econometric issues:
 - ▶ Use standardized coefficients in order to enable comparison of coefficients across models.
 - ▶ Optimal regression method with categorical dependent variables? (multinomial logit, ordered probit)
 - ▶ Tests for multicollinearity? ⇒ The literacy score is correlated with demographic variables, which could lead to large standard errors in the models where all variables are included.

Where could we go from here?

- ▶ What are the theoretical implications of the results?
- ▶ How do the results relate for instance to behavioral theories?
- ▶ How could the results be used to test different theories regarding the formation of inflation expectations?
- ▶ What are the implications for the design of surveys for inflation expectations and perceptions?