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The Macroeconomic Effects of Inflation Expectations: The Distribution Matters

Abstract

A monetary policy BVAR augmented with heterogeneous beliefs explores the macroeconomic effects in US data of shocks to the distribution of short-term inflation expectations, using the Michigan Survey. Throughout a comprehensive density impulse response function analysis, we show the importance of accounting for the whole expectation distribution.
Dispersion shocks are recessionary, via the effects on consumer sentiment, and the effects are sharper when the shock mass is condensed on the tails. Specifically, left-tail perturbations account for the largest effect of expectations shocks on macroeconomic fluctuations. Furthermore, our results show that the (not so) obvious benefits obtained by anchoring the inflation expectations consensus might be completely overthrown in the presence of excessive dispersion, a feature that central banks should take into account.