Inflation Expectations and Portfolio Rebalancing of Households: Evidence from Inflation Targeting in India

By Sumit Agarwal, Yeow Hwee Chua, Pulak Ghosh and Changcheng Song

Discussion:

Abhiroop Mukherjee

Summary

How do households change their consumption and savings/ investment decisions in response to changes in inflation expectations?

- No empirical consensus on the causal effect of inflation expectations on consumption, little to no evidence on overall household balance sheets
- Data and identification are key barriers
  - Data linking inflation expectations to household balance sheets rare
  - Inflation expectations typically change in step with other macro variables

Summary

- This paper: set-up
  - Examines the impact of inflation expectations on households' portfolio rebalancing decisions
  - Great data from India
    - Data on city-age group-gender level changes in
      - inflation expectations
      - credit/ debit card spending
      - savings and term deposits
      - ATM withdrawals
      - equity investments
  - Event-study style approach
    - Centered around the adoption of inflation targeting in India

Summary

- This paper: findings
  - A decrease in inflation expectations by 100 basis points led to:
    - Decrease in risky investments by 2%
    - Increase in bank deposits by 22%
    - No significant effect on consumption
  - Evidence consistent with nominal rigidity in savings deposit rate

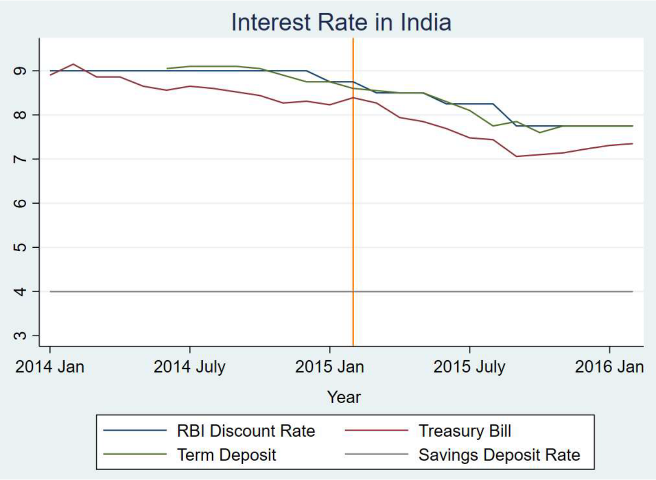
Thoughts

- Topical paper, on an important theme
  - Very nice link between inflation expectations and household balance sheets
    - Unique data makes this possible
  - Important window into a critical policy change in India
    - What happens when a large, heterogeneous economy adopts inflation targeting is independently important to study
  - Clever design
    - Not just regional differences in inflation/ inflation expectations, subject to macro-related identification concerns
    - Authors use recent literature on differences in expectations between groups etc. to generate within-region variation

Thoughts

- Role of bank officials and their incentives in behavioral changes

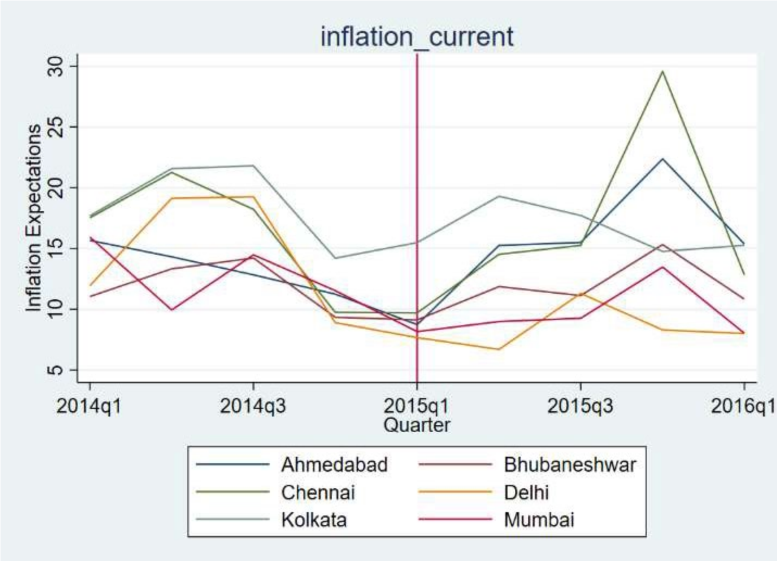
- Largest effect on deposits
  - Term deposits very important savings instrument in India



  - Was this driven by bank officials telling people that interest rates will fall due to new policy, so you guys should all start/ renew term deposits to lock-in current rates?
  - This would mean that the individual's inflation expectation not necessarily driving their decision

Thoughts

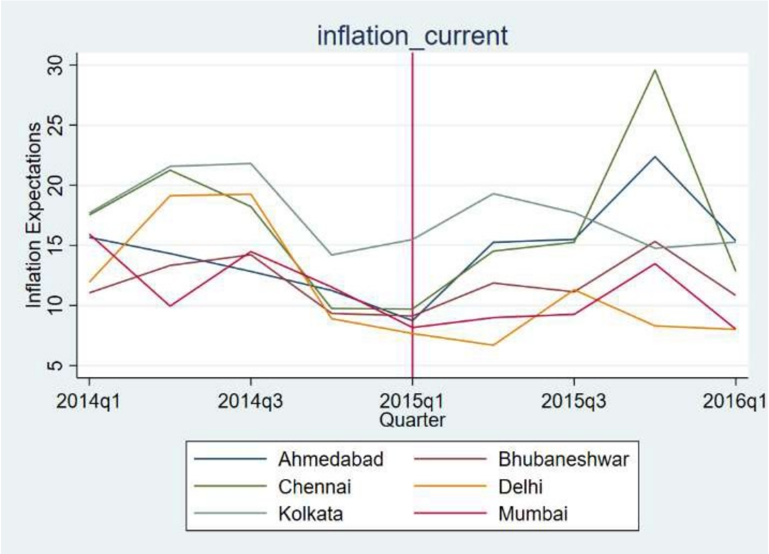
- Average inflation expectation doesn't really jump after targeting is introduced



  - Not necessary that they should have jumped
  - Except in Delhi, the expectation levels seem a lot higher than the target of 6% or 4%
  - Clearly, the average person's behavior is not consistent with rational expectations here

Thoughts

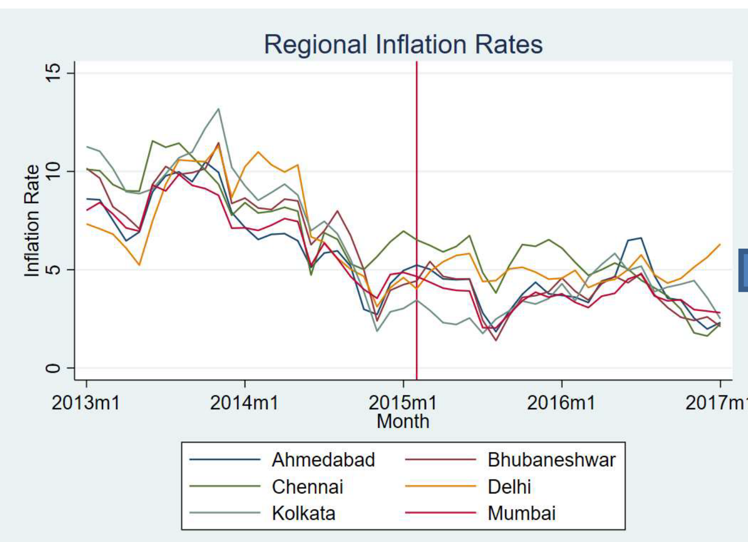
- Inflation expectations at the city-level seem to *diverge* after targeting

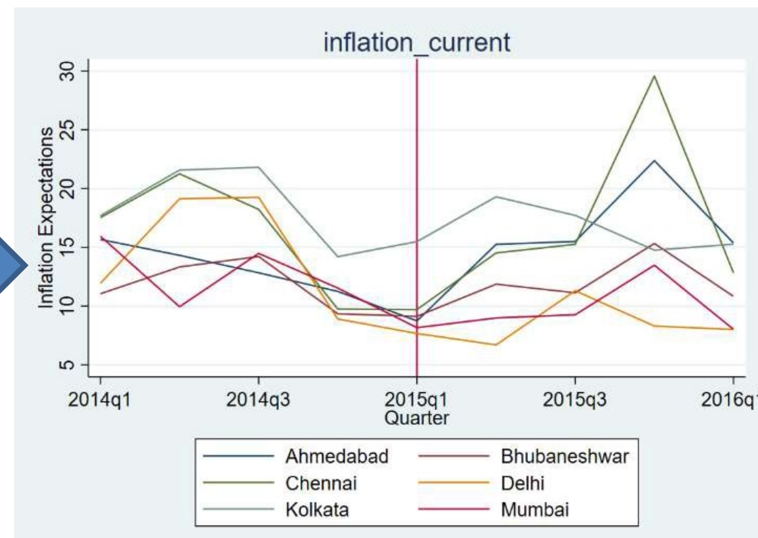


  - My prior was that belief disagreement comes from two things:
    - What the RBI wants to do
    - Can they do it
  - I would have expected beliefs to converge, due to clearer guidance on the former
    - Multiple targeting makes one second guess which target in critical

Thoughts

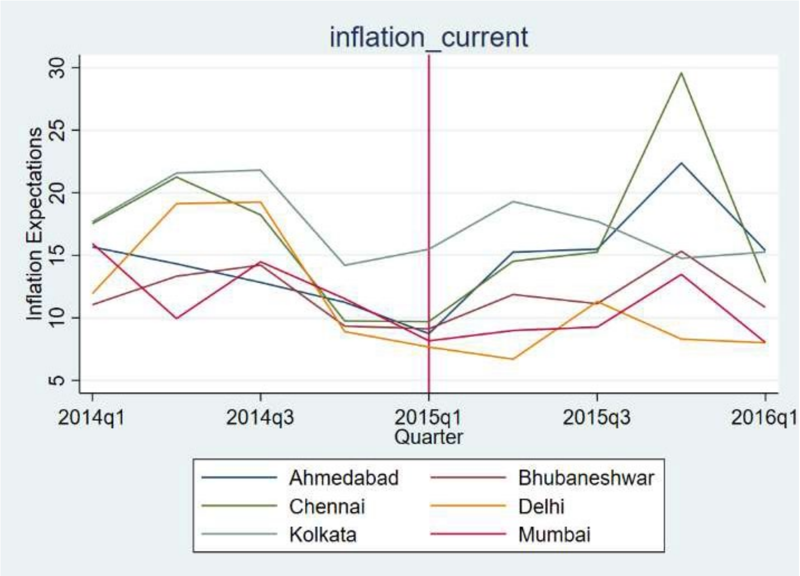
- Link between past inflation, policy and inflation expectations
  - Key to the paper is heterogeneity in inflation expectations around the policy change
    - Good to understand how people form inflation expectations
    - E.g., I live in Kolkata and see the RBI change to inflation targeting. But the 4% nation-wide is not really relevant to me. How do I figure out what this will mean for the inflation rate facing me in the future?





Thoughts

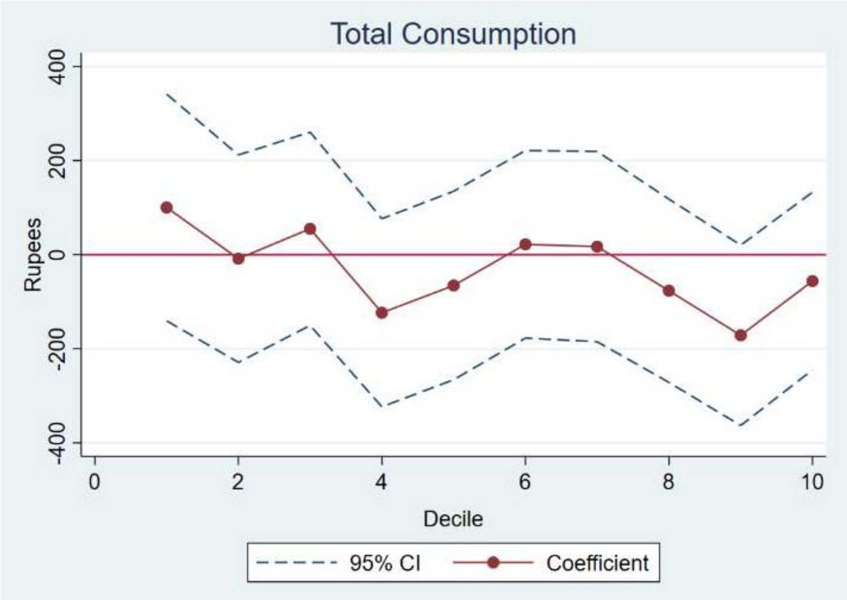
- Link between past inflation, policy and inflation expectations
  - Suggestion: Estimate a VAR to study joint evolution of variables
  - Examine whether ex-ante there are any systematic differences in expectations depending on political polarization
    - E.g., those cities run by opposition parties to the BJP expect inflation to be higher



    - Hypotheses-driven differences linked to portfolios would perhaps be nicer

Thoughts

- Distributional consequences of monetary policy
  - Changes in inflation expectations do not change behavior of many who are poor
    - Makes sense: if one is struggling to make ends meet



Thoughts

- Distributional consequences of monetary policy

  - Not much clean evidence on household balance sheet limits to monetary policy
    - Financial flexibility is a luxury for the well-off in countries like India

  - How does this make monetary policy and its pass-through different in countries like India relative to the developed world?

  - Why is the deposit rate rigid? Is it because the government realizes that the poor don't have room to adjust? If so, is this policy achieving its goals?

Conclusion

- Interesting and well-done paper on an important topic
  - Thought provoking
  - All the best!