

Experience-Based Heterogeneity in Expectations and Monetary Policy

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An important question: how does expectational heterogeneity matter for monetary policy?

This paper: a New Keynesian model with experience-based learning (EBL)

- Agents behave like econometricians, forming expectations of future economic variables based on parameters estimated from a time-varying AR process
 - Expectational heterogeneity comes from differences in perceived persistence of economic variables
 - Following Malmendier and Nagel (2016), agents place more weight on recent observations, ignoring data prior to birth.
- Demographics affect aggregate expectations through a composition effect.
- The **Experience Channel** matters for the transmission of monetary policy.

- Lower perceived persistence for younger cohorts
- Weaker effect of monetary policy on inflation
- Weaker pass through of monetary policy and a smaller tradeoff in stabilizing output and inflation

- Optimal degree of gradualism
- Importance of managing expectations
- Committee composition

Cohort effects versus lived experience— cohorts may differ in many dimensions other than the sequence of shocks they observe:

- Sectoral employment (manufacturing versus services)
- Portfolio composition
- Rural versus urban residences (and car ownership rates)
- Composition of consumption
- Attentiveness to inflation (Candia, Coibon, and Gorodnichenko, 2020)

To disentangle cohort effects versus lived experience, would it be possible compare analysis across different countries or US states?

- The effects of monetary policy are stronger and more persistent in older societies than younger ones

Japanese experience

- As a population skews older, the perceived persistence of shocks increases, resulting in higher aggregate volatility

Greater macroeconomic stability in older, developed countries

- Younger cohorts have a lower perceived persistence of economic variables

Great Recession

→ The results are about averages, but is that useful for policymakers?

- Does it matter if the transmission of monetary policy is weaker if shocks are also perceived to be less persistent?
- The effect of monetary policy on demographics (Cummings and Dettling, 2019)