MONETARY POLICY, FIRMS’ INFLATION EXPECTATIONS AND PRICES: CAUSAL EVIDENCE FROM FIRM-LEVEL DATA

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MOTIVATIONS
Modern macro assigns a central role to expectations and pricing choices of monopolistic price-setters in shaping the economy’s response to MP.
Yet, mostly due to lack of suitable data, price setters have been largely neglected by empirical research exploring responses to MP.
Do firms’ expected inflation and pricing strategies respond directly to MP news or response is slower, mediated by financial markets?
Is the ECB still able to steer price-setters’ inflation expectations and choices at the ELB?

DATA

CONTRIBUTIONS
Causal evidence on the response of firms’ inflation expectations and pricing strategies to ECB’s monetary policy news.
Combine standard macroeconomic approach of measuring MP surprises with high frequency financial market movements around central bank communications with firms’ survey data

Advancements:
1) focus on firms;
2) exploit quantitative data on expectations at several horizons on consumer price inflation (HICP) and on own price dynamics;
3) investigate main channels; 4) use well-identified monetary policy shocks.

RESULTS PREVIEW
Sizeable causal response of expected inflation to MP news, stronger at ELB and associated also with movements at long end of term structure.
No significant effect on own future price dynamics, possibly also a reflection of offsetting transmission channels.
Little evidence that MP news shape perceived demand pressures or cost (wages and materials) push.

EMPIRICAL STRATEGY
Almost all fieldworks (each ~25 calendar days) of the survey include a scheduled GC monetary policy meeting.
We explore whether the difference between expectations collected just after and just before any GC meeting is systematically related to standard gauges of monetary policy surprises defined by movements in market rates around the relevant GC meetings.

FIRMS’ EXPECTED INFLATION AND MONETARY POLICY SURPRISES

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\pi_{it} = \alpha + \beta \Delta R_{i,t-1}^{ECB} + \gamma \pi_{i,t-1} + \delta X_{it} + \epsilon_{it}
\]

\[
\Delta \pi_{it}[0 \text{ if interviewed before GC; change in relevant rate on GC day if interviewed after GC}] = \Delta \pi_{it}(\text{if interviewed before GC; change in relevant rate on GC day if interviewed after GC})
\]

Other Effects of Monetary Policy Shocks?

Results of \( BL \) tests for 10th, 25th, 50th, 75th, and 90th percentiles:

Theoretically consistent, statistically and economically significant response of firms’ \( \pi_{it} \) at all horizons considered to MP news that affect the short and the long ends of term structure of interest rates.
Evidence of (rational?) matteness: no response when \( \pi \) stable and objective-consistent; more sizeable one at unusual times…
…, but do MP shocks affect firms pricing decisions? Not quite. Overall, lack of statistically significant response of own prices with point estimates tilted towards positive values.

SUMMING UP…

Coexisting offsetting channels (e.g. demand vs cost channel)? A theoretical possibility but at first inconsistent with lack of effects on firms’ assessments of role of demand pressures and of cost push factors. Yet, very coarse qualitative measures

...contrasted with shocks of limited size.

Other explanations? Empirically, time- and state-dependent pricing models imply sizeable heterogeneity of firm-level price dynamics around average dynamics, thus leading to weaker statistical significance of same shock; also, inflation expectations refer to consumer prices whereas own price developments refer to producer prices; menu costs...

Next, complement with measures of media coverage of each GC communication, consider narrower windows around GC communication events (EA-MPD)