Discussion: Inflation and Wage Expectations of Firms and Employees

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Summary

RQ. What is the pass-through between inflation expectations and wage growth expectations?

1. Average pass-through is around 0.1-0.2 for firms and 0-0.08 for employees. Higher pass-through for:
   - Men, younger respondents, higher-income respondents.
   - Large firms, firms that lack skilled labor, those in services and manufacturing sectors.
2. Mechanism 1: Wage rigidities
   - The idea: Nominal wages catch up with realized inflation.
   - For firms: wage growth expectations correlate significantly with realized inflation.
   - For employees: similar to firms for realized inflation, not so much for perceived inflation.
3. Mechanism 2: Role of bargaining
   - Small correlation between inflation expectations and bargaining intensity.
   - Higher pass-through when employees have higher bargaining power.

Comments

Very interesting paper, shedding more light on how individuals' expectations about different macroeconomic aggregates are related.

Four comments:

1. Survey design: How to interpret wage growth expectations?
2. How should we think about pass-through?
3. Does the source of the rise in inflation expectations matter?
4. Inflation expectations and uncertainty about wage growth.

1. Wage growth expectations

I wasn't able to find information on how wage growth expectations were elicited.

1. Unconditional wage growth expectations?

$$\mathbb{E}(w_{t+1}) = \mathrm{Pr}^{stay}\mathbb{E}(w_{t+1}^{stay}) + \mathrm{Pr}^{move}\mathbb{E}(w_{t+1}^{move}) + Pr^{nonemp}0$$

2. Wage growth expectations conditional on remaining employed?

$$\mathbb{E}(w_{t+1}|emp) = \mathrm{Pr}^{stay}\mathbb{E}(w_{t+1}^{stay}) + \mathrm{Pr}^{move}\mathbb{E}(w_{t+1}^{move})$$

3. Wage growth expectations conditional on remaining on the same job?

$$\mathbb{E}(w_{t+1}|\text{same job}) = \mathbb{E}(w_{t+1}^{stay})$$

Depending on how these expectations were elicited, the meaning of pass-through might be different:

- Example: if inflation expectations are correlated with the subjective expectations of labor market transitions.

2. How should we think about pass-through?

In the paper, pass-through is defined as the association between $\mathbb{E}_t(\pi_{t+1})$ and $\mathbb{E}_t(w_{t+1})$.

Why are we interested in inflation expectations?

- From an aggregate, monetary policy perspective:

$$\mathbb{E}_t(\pi_{t+1}) \to w_{t+1} \to \pi_{t+1} \to \mathbb{E}_{t+1}(\pi_{t+2})$$

Where do wage growth expectations fall in this chain?

- This paper: $\mathbb{E}_t(\pi_{t+1}) \to \mathbb{E}_t(w_{t+1}) \to w_{t+1} \to \pi_{t+1} \to \mathbb{E}_{t+1}(\pi_{t+2})$
- The added link would enhance the strength of the spiral.

2. How should we think about pass-through?

- Alternatively: consumers might have a mental model of expectations formation where,

  $$\pi_t, w_{it}, \chi_{it} \to \mathbb{E}_t(\pi_{t+1}), \mathbb{E}_t(w_{t+1})$$

  and when deciding how much wage to ask for (if they have any bargaining power),

  $$\mathbb{E}_t(\pi_{t+1}), \mathbb{E}_t(w_{t+1}) \to w_{t+1}$$

Can this regression be suggestive evidence for such a model?

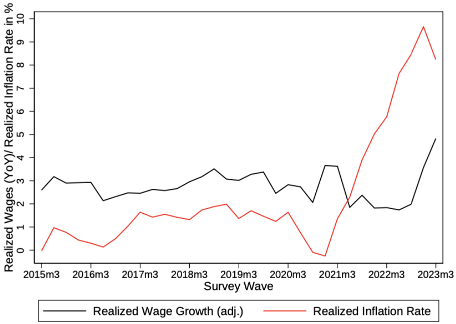
	Expected Wage Growth Next 12 Months				
	Firms		Employees		
	(1)	(2)	(3)	(4)	(5)
Expected Inflation Rate	0.234***	0.159***	0.056***	0.001	0.021
	(0.012)	(0.012)	(0.016)	(0.016)	(0.016)
Current Realized Inflation Rate		$\boxed{0.188^{***}\ (0.014)}$		0.209***	
				(0.022)	
Current Perceived Inflation Rate					0.099***
					(0.015)
Exp. Fundamentals	yes	yes	yes	yes	yes
Firm/Ind. FE	yes	yes	yes	yes	yes
Time FE	no	no	no	no	no
Observations	15742	15742	6130	6130	6106

2. How should we think about pass-through?

- Alternatively, inflation might have a lagged effect on expected wages, similar to realizations.

$$\pi_{t-1}, \pi_{t-2}, \pi_{t-3}, \ldots, w_{it}, \chi_{it} \rightarrow \mathbb{E}_t(w_{t+1})$$

- This would perhaps imply the spiral would continue for extended periods of time.



Bottomline: The model we have in mind, will have implications on how we interpret the results presented and on policy design.

Question: If we find different pass-through levels for firms and consumers, which pass-through is more important for policy makers?

3. Does the source of the rise in inflation expectations matter?

The paper focuses on a period of rising inflation after December 2021.

According to the ECB, inflation in the Euro-area:

- Supply-driven early on with supply bottlenecks and labor shortages in early 2021.
- With pandemic restrictions being lifted, became more demand-driven starting with 2022.

Question: Could the source of inflation matter for pass-through?

- Should we expect to see different levels of pass-through when change in inflation expectations are demand- or supply-driven?

4. Inflation Expectations and Wage Growth Uncertainty

For future research: Is there a link between inflation expectations and wage growth uncertainty?

We already know:

- Carroll and Kimball (1996): income uncertainty makes the consumption function concave.
- Coibion et al (2022): households decrease their spending on durables and propensity to invest when they are given information about higher macroeconomic uncertainty.
- Kosar and Melcangi (2023): higher subjective wage growth uncertainty is associated with higher MPCs, but not for very high uncertainty levels.

If inflation expectations increase wage growth uncertainty, the overall effect may be unclear:

- Higher uncertainty, lower consumption on durables, lower demand.
- But if coupled with a fiscal stimulus: higher uncertainty, higher mpcs out of stimulus, higher demand, upward pressure on prices.