Inflation Expectations and Households Portfolio Choice

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What this paper does

The question: how do beliefs about future inflation affect households' portfolio decisions?

The strategy:

- Data from long running (since 1993) survey of Dutch households' finances - very well documented
- Inflation experience (as in Malmendier-Nagel 2016 QJE) used as instrument - a very credible one - for inflation expectations. Assess effect on investment in risky assets:
    - Extensive margin (equity market participation)
    - Intensive margin (risky portfolio share)
- Depth of data allows for additional exercises:
    - Leveraging on detailed security-level data, further analysis of effects on portfolio performance
    - Assess heterogeneity of expectations and effects on portfolio choice across population subgroups

What this paper does

The results:

- Main result. A 1 p.p. increase in inflation expectations leads to:
  - $\uparrow \approx 3\%$ higher probability to hold risky assets (equity/stocks)
  - $\uparrow \approx 30\%$ risky assets holdings
  - $\uparrow \approx 2$ p.p. (6 p.p.) higher portfolio share of stocks (equity)
- Additional results:
  - Effect heterogeneous across different segments of the population: **age; self-reported financial literacy; income class; gender**
  - $\uparrow$ risky assets investment associated with inflation $\Rightarrow \uparrow$ portfolio performance
- Main channels proposed:
  - Income: Inflation expectations $\rightsquigarrow$ future income expectations ($\leadsto$?)
  - Nominal savings: stocks/risky asset provides inflation hedge

Comment 1: Make contribution more clear

Paper includes comprehensive lit review focusing on two topics:

Role of inflation expectations in portfolio choice

- At face value, Agarwal et al. (2021) seem to do roughly the same
  - Policy experiment in India: $\downarrow E(\pi) \Rightarrow \downarrow$ risky portfolio share

Role of stocks as hedge against inflation

- Conclusions of Aoki et al. (2019) go in the same direction
  - Model-based approach, estimated with SCF data: $\uparrow E(\pi) \Rightarrow \uparrow$ equity portfolio share

In this context, **what is new?**

- Paper seems to hint at "a lack of identification strategy" in previous results. If so, better to:
  - Point out directly the shortcomings of these previous papers
  - Explicitly lay out the novelty and improvement brought to the table (experience instrument?)

Comment 2: try to clarify theoretical framework

Tall order: thinking about portfolio choice in a nominal framework

Conceptual framework not obvious.

- Channel 1: income expectations. $\uparrow E(\pi) \Rightarrow \uparrow E(\mathbf{income}) \Rightarrow \uparrow$ risky investment
  - Shock to expectations of future *real income*? Then $\downarrow$ saving (but maybe % risky $\uparrow$?)
  - If by $\uparrow E(\mathbf{income})$ just mean a nominal increase, then might even be neutral to saving? (Nominal rigidities in wages of course, but then must be explicit!)
- Channel 2: nominal rigidities in deposit rate. $\uparrow E(\pi) \Rightarrow \downarrow E(r) \Rightarrow \uparrow$ risky investment
  - But in practice (and again very topical) typically due to MP an inflation (expectations) shock is followed by an increase in interest rates. How might this change this implication?

A more detailed explanation (maybe toy model?) would greatly help in interpreting the results.

Namely: exercise with *income expectations* hard to interpret.

Comment 3: details?

Data work

- Data very well documented, which is a plus. But some details too much and best left to Appendix:
    - Survey questions; variable levels; etc.
- One important detail is not clear though: **intra-household splits**.
    - Even though a robustness check on this is reported (as a footnote) it would be useful to explain how asset holdings and investments are split within households (e.g. between spouses)
    - Could matter e.g. for results on gender.

"Baseline model" probably not necessary to include?

- The basic model, on self reported expectations, is distracting (if it could be trusted, why the IV?)
- Paper very explicit and clear about different elements in the IV framework, that should be enough

Great work so far!

Thank you for your attention. Q: luis.teles.m@novasbe.pt