Discussion of

“The Role of Financial Literacy in Anchoring Inflation Expectations: The Case of Ukraine”

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Determinants of household inflation expectations

Important and policy-relevant question:

- Central banks rely on inflation targeting to anchor inflation expectations and stabilize the economy
- Inflation expectations matter for numerous household decisions

Financial literacy → $\boldsymbol{E[\pi]}$:

- More literate households tend to have lower and more accurate inflation expectations (Bruine de Bruin et al., 2010, Lusardi & Mitchell, 2014, Rumler & Valderrama, 2020)
- Limited evidence for developing and emerging market economies

The case of Ukraine

- The medium-term inflation target is **5%,** but the household expectations typically exceed it
- The financial literacy is lower than in advanced economies but rapidly growing
- How much does financial literacy matter for inflation expectations?

Figure 1: CPI change (end-of-period, % YOY) and inflation target

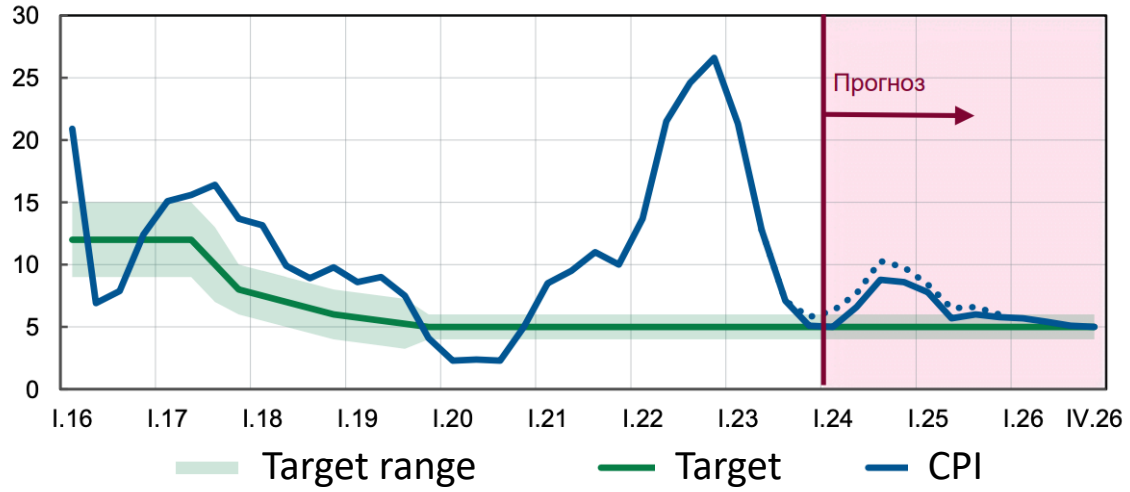
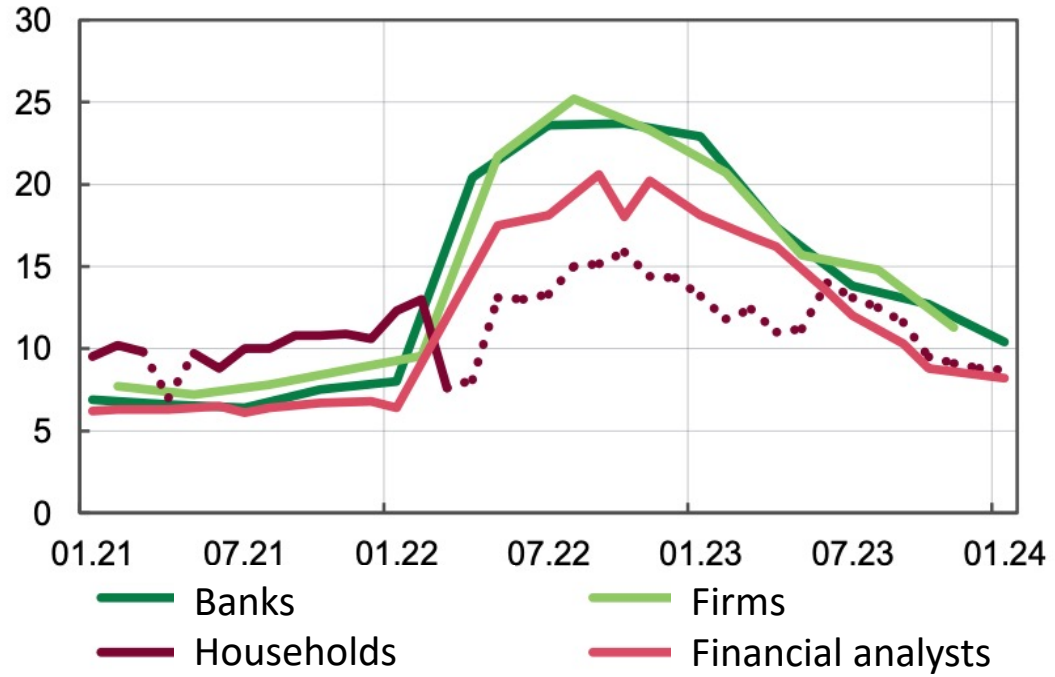


Figure 2: Inflation expectations in the next 12 months, %



This paper

USAID Info Sapiens survey (August 2021)

- The Financial Literacy Index is calculated according to OECD methodology
- Information about inflation:
  - Perceptions of inflation in the past 12m
  - Expectations in 1y and 3y horizon

Findings:

- Higher financial literacy:
  - Improves inflation perceptions and the accuracy of inflation predictions
  - Decreases $E_t[\pi_{t+12}]$ but increases $E_t[\pi_{t+36}]$
- The effects are asymmetric for different quantiles of inflation expectations
  - The effects are the strongest in the upper percentiles of inflation expectations
  - Exception: Increase in $E_t[\pi_{t+36}]$ is most pronounced if expectations are close to 5% target

Identification

- Use IV to overcome the endogeneity of inflation expectations:

$$E[\pi]_i = \alpha_0 + \alpha_1 FLI_i + \boldsymbol{X_i'\gamma} + \varepsilon_i$$

$$FLI_i = \beta_0 + \beta_1 risk\_aver_i + \beta_2 exper_i + \boldsymbol{X_i'\theta} + \nu_i$$

where $risk\_aver$ is highest education level – number of times as victim of financial fraud and $exper_i$ refers to investment experience

- Why is $\alpha_1^{OLS} > \alpha_1^{IV}$? What could be the omitted variable? (e.g., IQ, experiences during adolescent years)

Possible Extensions

1. Different measures of financial literacy
2. Heterogeneity by demographic characteristics
3. Explaining outliers

1. What is financial literacy?

The InfoSapiens FLI measure is the sum of 3 scores:

1. Financial attitudes (responsible actions)
2. Financial behaviors (experience)
3. Financial knowledge (percentages, **inflation**, risk)

Economic literature commonly focuses on the **financial knowledge** component (Lusardi and Mitchell, 2014)

How do different components of financial literacy score affect inflation expectations? (Financial knowledge is easier to change than behaviors.)

Note: Economic literacy (e.g., understanding monetary policy objectives, relationship between inflation and unemployment) is not measured (Andre et. al, 2022, Carvalho and Nechio, 2014)

2. Role of demographic characteristics

- Is there heterogeneity in the effect of financial literacy by demographic characteristics (e.g., by age, gender)?
  - Interaction terms between financial literacy and demographics
  - Interaction with trust in banking institutions

- May inform whom to target with tailored information sessions

3. What do extreme responses mean?

- Most papers drop outliers. But they may matter.

- Quantitative evidence:
  - Extension of analysis for groups with anchored and unanchored expectations
    - Sensitivity to 75p cutoff for unanchored expectations
  - Who is an outlier? Predict status given observables
    - Are these very “illiterate” people?

- Qualitative evidence:
  - How likely is 0 = “I don’t know” or “I don’t care”
  - In-person interview: What is the interviewer's script if someone says 0 inflation? How about inflation >50%? Can you access the interviewer's notes?

Overall

- Well-written policy-relevant paper
- Careful attention to specification choice and addressing outliers
- Many potential ways for extensions

- Additional evidence could help better target financial literacy interventions

- *Could design a new survey experiment using the existing financial literacy tools (e.g., website "Harazd")*

References

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Lusardi, A., & Mitchell, O. S. (2014). The economic importance of financial literacy: Theory and evidence. *Journal of Economic Literature*, *52*(1), 5-44.