

# Liquidity Constraint, Optimal Attention Allocation and Inflation Expectations of Households\*

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## Abstract

We theoretically and empirically investigate formation processes of inflation expectations of households. We develop a rational inattention model of households who attempt to minimize the expected loss from insufficient *bargain-hunting* and inefficient *inter-temporal consumption allocation*. The households allocate their attention to information about two variable: the lowest price in the current period and the aggregate inflation rate which a central bank aims to achieve in the long-run. The key prediction of the model is that inflation expectations of households with tighter liquidity constraint exhibit higher correlation with their own experienced inflation (i.e. inflation perceptions). Such households are also less attentive to information about the inflation rate targeted by the central bank. We then empirically validate our model by testing these predictions with a micro-dataset on Japanese households. We finally draw a critical policy implication from the valid model that alleviation of the liquidity constraint by monetary easing affects households' optimal attention allocations and finally promotes effective central bank communication on its targeted inflation.

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