

Firms' Inflation Expectations
under Rational Inattention and Sticky Information:
An Analysis with a Small-Scale Macroeconomic Model*

Tomiyuki Kitamura[†] and Masaki Tanaka[‡]

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Abstract

In this paper, we construct a small-scale macroeconomic model that incorporates three hypotheses on the formation of inflation expectations: the full-information rational expectations (FIRE), rational inattention, and sticky information hypotheses. Using data for Japan, including survey data on firms' inflation expectations, we estimate the model to examine the empirical validity of each hypothesis, and analyze how rational inattention and sticky information affect the dynamics of firms' inflation expectations. Our main findings are twofold. First, each one of the three hypotheses has a role to play in explaining the mechanism of the formation of firms' inflation expectations in Japan. In this sense, the manner in which firms form their inflation expectations in Japan is complex. Second, although firms' inflation expectations have been pushed up by the Bank of Japan's introduction of its "price stability target" and the expansion in the output gap amid the Bank's Quantitative and Qualitative Monetary Easing (QQE), the presence of rational inattention and information stickiness has slowed the pace of the rise in firms' inflation expectations.

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[†]Monetary Affairs Department, Bank of Japan (E-mail: tomiyuki.kitamura@boj.or.jp)

[‡]Monetary Affairs Department, Bank of Japan (E-mail: masaki.tanaka-2@boj.or.jp)