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The Rockets and Feathers of Inflation Attention

Oleg Korenok * David Munro[†]

July 2024

Abstract

Prior research has documented that attention to inflation shifts when inflation surpasses a 3-4% threshold. In this note we examine how attention to inflation declines in episodes of disinflation. We show that for countries where inflation has returned to “normal” (pre-threshold) levels, attention remains 2-3 times higher than it was before the run-up of inflation. We show evidence that wage growth is more strongly correlated with past inflation when attention is high. This is one possible mechanism behind the slower-than-expected disinflation in late 2023 and early 2024.

Keywords: inflation; attention; persistence; threshold.

JEL Codes: E31, E52, E70

1 Introduction

One of the dangers of high inflation is that it causes households and businesses to pay closer attention to it. This increased attention runs the risk of causing inflation becoming more entrenched in decisions, making inflation more persistent. Recent research has documented that attention to inflation increases with inflation: Coibion et al. (2018), Bracha and Tang (2022), and Korenok et al. (2023). Korenok et al. (2023) and Pfäuti (2023) also report evidence of a structural shift in attention above about 4% (in the US). In particular, Korenok et al. (2023) report that below 4% inflation, there is a weak correlation between the level of inflation and measures of attention (i.e. people ignore it), but above 4% this relationship becomes strong.

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After a dramatic increase of inflation in 2021-2022 in the U.S. and around the world, inflation rates have since declined, raising an important question about attention: does it return to normal as inflation subsides, or are there some lasting effects from these periods of heightened attention? Our analysis in Korenok et al. (2023) focuses on the run-up of inflation and attention in 2021-2022, and in this paper we revisit this analysis with a particular interest in how attention changes during a period of disinflation.

We find that while attention to inflation has subsided as the rate of inflation has fallen, it remains 2-3 times higher than it was for similar levels of inflation prior to entering the high attention regime. Thus, there appears to be substantial persistence in attention to inflation even as inflation has fallen. What we observe for inflation attention is akin to a "rockets and feathers" phenomenon, with attention rising quickly as inflation increases but falling slowly as inflation subsides.¹

We discuss several interpretations regarding the causes of elevated inflation attention including inflation's persistence and volatility and we explore the economic significance of elevated attention. Kamin and Roberts (2023) report evidence that wage growth is correlated with past inflation. We replicate their results and show that this correlation is significantly stronger when attention to inflation is high. One interpretation of these results is that inflation becomes more of a focal point in wage bargaining when attention is high which, in turn, causes inflation to become more persistent. This is one possible mechanism behind the slower-than-expected disinflation experienced in late 2023 and early 2024.

2 Analysis

In Korenok et al. (2023), we identified a group of countries where the correlation between inflation levels and measures of attention was weak when inflation level was below a certain threshold but strong above it. In this paper, we leverage the fact that inflation in some of these countries has returned below this threshold. This allows us to explore the changes in attention towards inflation in these countries as inflation fell below these thresholds.

¹Bacon (1991) noticed that gasoline prices rise quickly after oil price increase, but they fall slowly after oil price decrease. He called this asymmetric response "rockets and feathers." Further investigations confirmed existence of this asymmetry (see a survey by Ederington et al. (2019)). Similar asymmetry was also reported in other markets (vegetables Ward (1982), meat Goodwin and Harper (2000), consumer deposits Neumark and Sharpe (1992), 242 various markets Peltzman (2000)). For theoretical models that rationalize rockets and feathers see Rebelo et al. (2024) and Westphal (2024).

2.1 Data

For consistency in the definition of inflation across countries, we use the OECD measure of inflation on all items using the COICOP classification. We obtain the most recent data (either March or April 2024 depending on the country) from the Federal Reserve Bank of St. Louis Economic Data. Google search data was obtained from Google Trends, see Korenok et al. (2023) for more details on Google Trends data collection.

2.2 Results

2.2.1 Internet Search

We begin our analysis using internet searches for “inflation” as our proxy for attention. The disinflation experienced since 2022-2023 allows us to examine how attention to inflation has retreated. As an illustrative example, we display our results for the U.S.

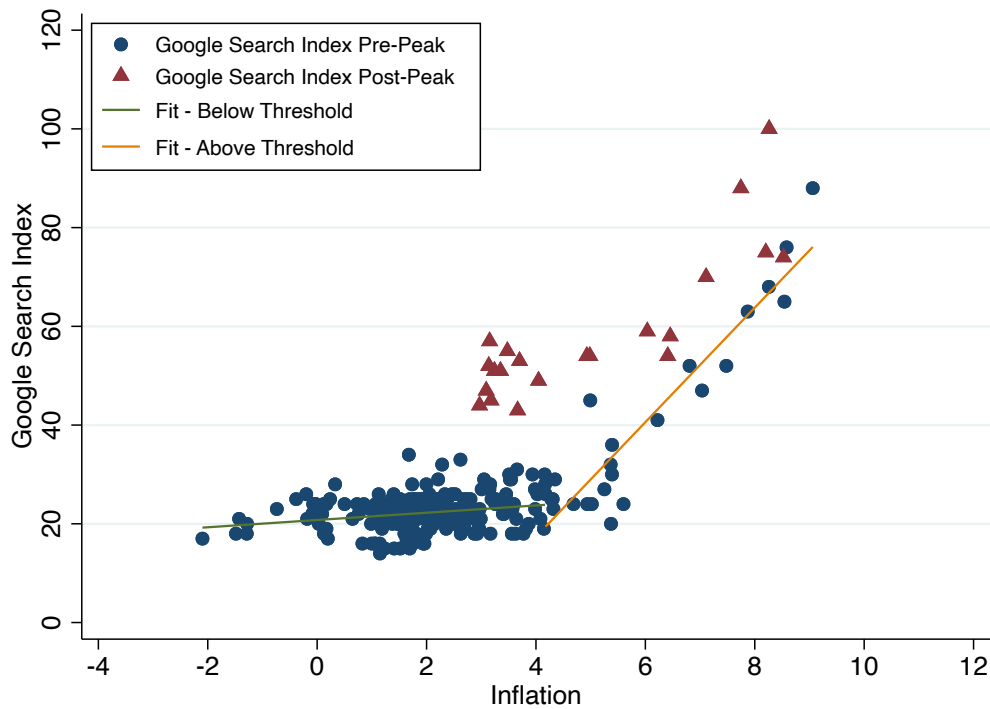


Figure 1: USA threshold model using Google searches

Figure 1 plots the inflation Google search index for the U.S. The blue dots are data prior to the peak of inflation (June 2022), and the red triangles plot the post-

peak data. A threshold model fitted on pre-peak data yields a structural break at 4.18% inflation.² As is clear from this figure, attention towards inflation has declined as inflation has declined in the post-peak period, but attention has stayed at a much higher level relative to similar levels of inflation prior to the peak. To quantify this difference, we observe that the lowest inflation rate in the post-peak period is 2.96%. The mean Google search index in the 2.96%-4.18% inflation range in the pre-peak period is 24.1. In the post-peak period, the mean of the Google search index in this inflation range is almost exactly double: 49.7. A t-test of a difference in means yields a p-value < 0.01. Thus, the post-peak inflation attention is twice as high for similar levels of inflation below the attention threshold.

We repeat the same analysis for the seven other countries that showed clear evidence of structural breaks in attention in Korenok et al. (2023) and who have also experienced inflation rates that have fallen below the estimated thresholds. These countries include: Belgium, Canada, Denmark, Finland, Germany, Poland, and Spain.

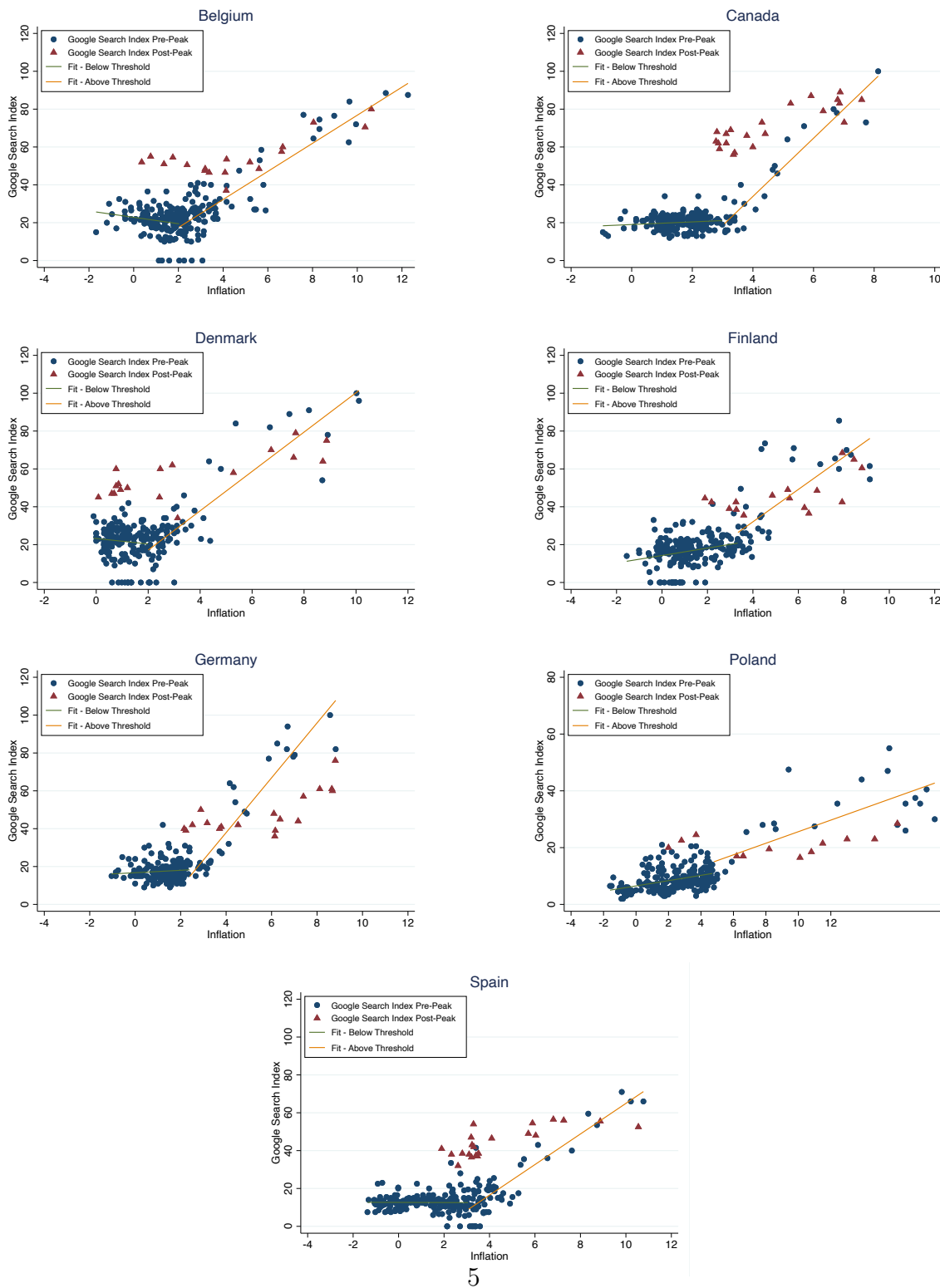
Table 1: Attention Comparison Pre vs. Post Inflation Peak

Country	Comparison Inflation Range	Mean Google Searches		p-value
		Pre-peak	Post-peak	
Belgium	0.36-2.04	20.6 [98]	53.1 [4]	< 0.01
Canada	2.78-3.06	22.5 [6]	63.0 [4]	< 0.01
Denmark	0.09-2.00	21.6 [148]	50.1 [8]	< 0.01
Finland	1.89-3.34	19.9 [46]	41.4 [5]	< 0.01
Germany	2.15-2.40	23.6 [11]	39.5 [2]	< 0.01
Poland	2.00-4.80	9.3 [112]	22.3 [3]	< 0.01
Spain	1.89-3.08	12.4 [58]	37.4 [4]	< 0.01
USA	2.96-4.18	24.1 [38]	49.7 [11]	< 0.01

For each of these countries, we follow the same comparison as with the U.S. We

²This threshold is somewhat higher than the baseline estimate for the U.S. in Korenok et al. (2023) of 3.55%. This original estimate did not include the ultimate peak of inflation in the U.S., and thus difference is driven by using slightly different data samples in the run-up of inflation.

Figure 2: Threshold model results for other countries



compute the range of inflation below the threshold and above the minimum observed inflation in the post-peak period. We then compare the Google index values in those inflation ranges in the pre-peak and post-peak periods. These results are summarized in Table 1 and scatter plots of these relationships are presented in Figure 2. For each country in Table 1 we report the comparison inflation range, the mean values of inflation searches in that range in the pre-peak and post-peak periods (along with the number of observations, reported in square brackets below), and the p-value of a t-test for a difference in means. For all countries we see that attention to inflation remains significantly elevated in the post-peak period.

2.2.2 Newspaper Coverage

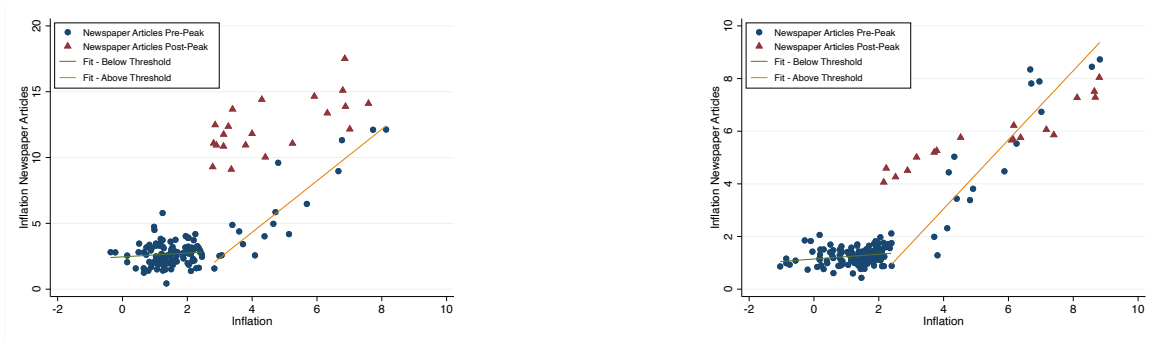
Google searches are but one proxy for attention. As a robustness exercise we explore if these patterns hold for a different measure of attention: newspaper reporting on inflation. We follow the same approach as Korenok et al. (2023) and find the share of newspaper articles containing the term "inflation" from the Proquest Database.³ From the set of countries we examine above Canada, Germany, and the U.S. have major national newspaper data in this database. We extend this data until March (Canada and USA) or April (Germany) 2024 and conduct the same analysis as above.

We begin with the U.S., which has an estimated threshold in the newspaper coverage of 3.87%. As above, the minimum inflation observed post June 2022 is 2.96%, which gives a comparison inflation range of 2.96-3.87%. The average share of inflation newspaper articles in this comparison range in the pre-peak period is 5.06% [n=29] vs. 7.53% [n=10] in the post-peak period (p-value < 0.01). For Germany, the comparison range of inflation is 2.15-2.39%. The average share of inflation newspaper articles in this range in the pre-peak period is 1.51% [n=6] vs. 4.33% [n=2] in the post-peak period (p-value < 0.01). Unfortunately, for Canada, there are no observations in the post-peak period that have registered below the estimated threshold of 2.45%, so we do not attempt any quantitative comparison on newspaper attention to inflation. However, qualitatively, panel a) of Figure 3 shows a similar shift in attention towards inflation despite having yet to cross the 2.45% threshold.

Overall, these results are consistent with those obtained using the Google search data in documenting attention to inflation below the threshold remains significantly elevated in the post-peak period relative to similar levels of inflation in the pre-peak period.

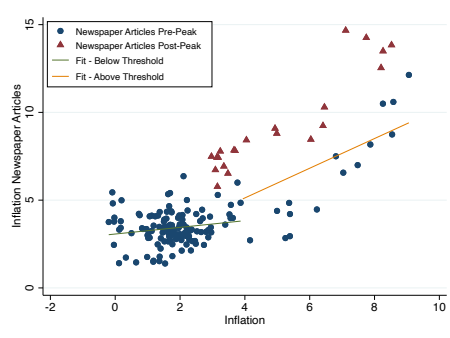
³See Korenok et al. (2023) for more details on how this data was constructed.

Figure 3: Contemporary Newspaper Coverage of Inflation



(a) Canada

(b) Germany



(c) USA

2.2.3 Historical Evidence

An important question in the context of this paper is the degree to which these findings are unique to the post-2020 spike in inflation. In Korenok et al. (2023), we examine an analogous historical episode of rising inflation using digitized newspaper coverage from the New York Times and Wall Street Journal. During the late 1950s and through most of the 1960s inflation was low and stable in the U.S., and experienced its first spike peaking in February of 1970. Focusing on this period of low and stable inflation and into the first run-up in inflation is somewhat analogous to the contemporary run-up episode and we find evidence of a similar threshold in inflation coverage (3.95%). After February 1970, inflation declined in the U.S. below this threshold, reaching a trough of 2.95% in August of 1972. To examine our question of persistent attention to inflation we examine this period. Following the same approach as above, we plot the pre-peak newspaper coverage for this run-up in inflation along with the newspaper coverage as inflation declined post-peak.

The estimated threshold in the pre-peak data occurs at 3.95% inflation, and the minimum level of inflation in the post-peak period is 2.95%, so our comparison inflation range is 2.95-3.95%. The pre- and post-peak data is plotted in Figure 4. The data is somewhat noisier than earlier results, but is generally consistent in showing that attention in the post-peak period remains significantly elevated even when inflation is below the estimated threshold.

The mean newspaper coverage for inflation levels between 2.95-3.95% in the pre-peak period is 0.75 and this rises to 1.41 in the post-peak period (p-value < 0.01). These findings provide evidence that attention persistence after a run-up in inflation is not unique to the contemporary episode.

2.3 Why is attention slow to decline?

Above we document that attention to inflation is slow to fall even when inflation has returned to "normal" (below threshold) levels. An interesting question involves understanding why this is the case.

One interpretation of the threshold patterns observed in Korenok et al. (2023) is that agents in the economy display rational inattentiveness: when the benefit of paying attention to inflation is low, households and businesses do not pay attention. The theory of Rational Inattention (RI) posits that inattention may be optimal due to costly cognitive resources (Sims (2003), Maćkowiak and Wiederholt (2009), Sims (2010)). A common formalization of rational inattention relates the level of attention to three factors (in this context of inflation): the cost of information about inflation, the volatility of inflation, and the persistence of inflation. For example, in Pfäuti

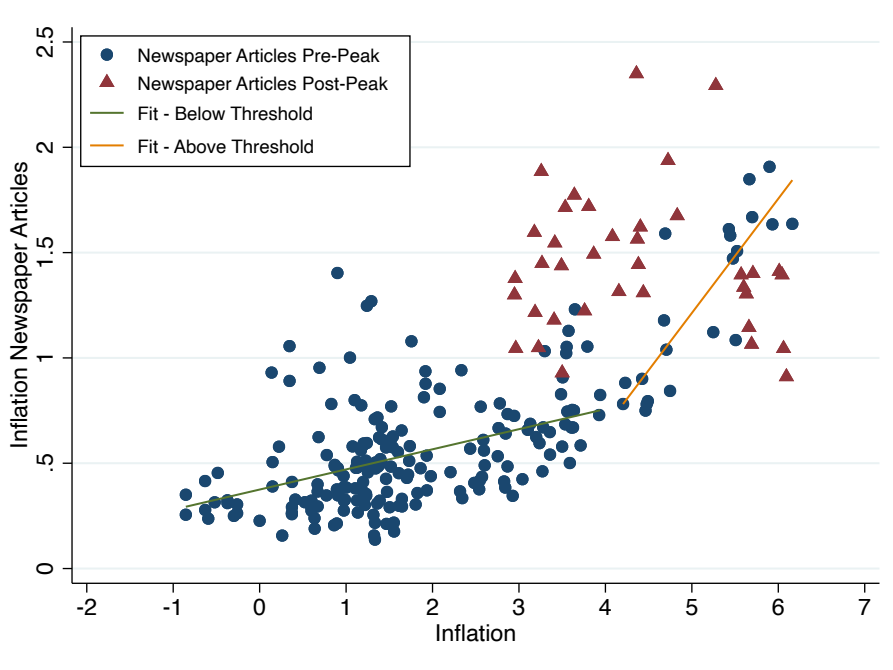


Figure 4: Historical Inflationary Episode in the U.S.

(2024), the level of attention is given by:

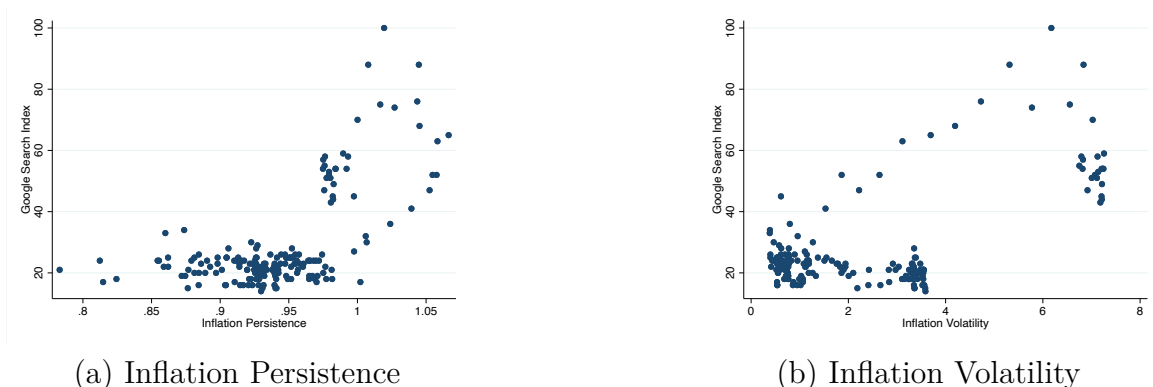
$$\gamma = \max \left[0, 1 - \frac{\tilde{\lambda}}{2\rho_{\pi}^2\sigma_{\pi}^2} \right] \quad (1)$$

where, over a certain threshold, attention (γ) is decreasing in the cost of information ($\tilde{\lambda}$), increasing in the persistence of inflation (ρ_{π}), and increasing in the volatility of inflation (σ_{π}).

Figure 5, documents the empirical relationship between attention and inflation persistence (panel (a)) or inflation volatility (panel (b)) for the U.S. In general, there is a positive association between attention and persistence and attention and volatility, consistent with the RI model and consistent with the results reported in Pfäuti (2024). Both panels also show a segment of the data where no relationship is present. Notably, for persistence, we see a similar non-linear relationship with attention, resembling results in Figure 2. We also see no real relationship for a segment of the data for inflation volatility. These segments of no relationship between attention and persistence or volatility are consistent with the RI model below the threshold (zero in (1)). We find similar patterns for other countries, which we plot in Figure A.1 and Figure A.2 in Appendix A.

Having established these generally positive associations between attention and

Figure 5: Attention versus Persistence or Volatility (USA)



persistence and volatility we now investigate if they will help shed light on why attention remains elevated. Specifically, in Figure 6 we plot 5-year rolling window estimates of U.S. inflation persistence and volatility.⁴ Persistence is the estimated AR1 coefficient and volatility is the variance of inflation.

Figure 6 shows that both of persistence and volatility measures increased during the spike in inflation. However, while the persistence measures have declined to almost pre-peak period level volatility remains seven times higher than its pre-peak level. We find similar patterns for other countries, which we plot in Figure A.3 in Appendix A. Thus, through the lens of rational inattention, it is perhaps not surprising that attention to inflation remains elevated in this post-peak period given that persistence and especially volatility remain elevated.

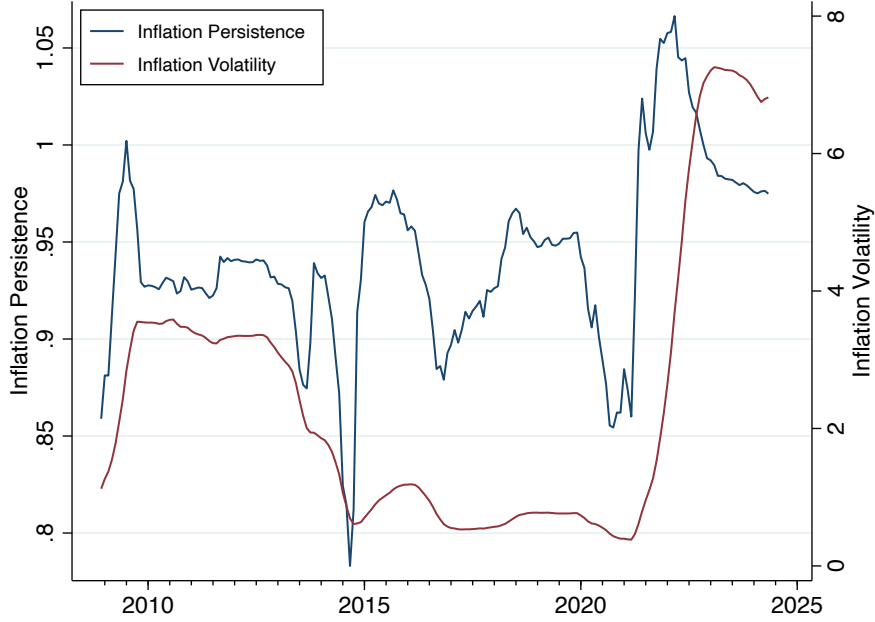
The cost of information on inflation ($\tilde{\gamma}$) is hard to measure directly, so we do not attempt to do so here. However, we simply note that the newspaper results reported above might suggest that these costs have lowered since 2022. If more newspaper coverage make it easier for agents in the economy to obtain information on inflation, the fact that newspaper reporting remains significantly higher for below-threshold inflation levels relative to pre-peak reporting could be one more factor keeping attention high.

It should be emphasized, though, that our analysis here is not necessarily direct evidence of this particular formalization of RI. We are simply exploring one possible interpretation of the drivers of elevated attention in this post-peak era. It is possible that alternative models of attention could explain elevated attention.⁵

⁴It is unclear what the optimal window is for accurately reflecting relevant economic conditions for agents in the economy. We use a 5-year rolling window as a reasonable first approximation.

⁵For example, a simple model where attention is just a function of a moving average of the *level* of inflation would likely show a similar pattern as Figure 6 because as the level of inflation spikes,

Figure 6: Inflation persistence and volatility (USA)



2.4 What are the consequences of elevated attention towards inflation?

The documented persistent heightened attention to inflation raises another intriguing question: how does this intense attention impact inflation?

Here we briefly discuss two interpretations. In RI model of Pfäuti (2024), attention affects inflation via inflation expectations. Specifically, attention governs how strongly agents update their expectations following an inflation surprise:

$$\pi_{t+1|t}^e = (1 - \rho_\pi \bar{\pi}) + \rho_\pi \pi_{t|t-1}^e + \rho_\pi \gamma (\pi_t - \pi_{t|t-1}^e) \quad (2)$$

According to the equation, elevated attention (high γ) increases inflation expectations if actual inflation is above expected inflation and decreases them if it is below. During the peak of inflation, actual inflation exceeded expectations. Even now, the majority of inflation surprises are positive. Consequently, heightened attention leads to higher expected inflation and, through the Phillips curve, results in higher actual inflation.

Rudd (2022) offers an alternative interpretation of inflation dynamics, suggesting that inflation exhibits highly persistent behavior when its trend level is above 4% (as seen in the 1960s-1980s) compared to when it trends around 2%. At higher inflation

persistence and volatility metrics do the same.

rates, the cost of living, driven by past inflation, becomes a significant factor in wage decisions. Workers are concerned about wages lagging behind the rising cost of living, causing current inflation to be influenced by past inflation. Conversely, at lower inflation rates, because inflation is not a primary concern for workers, current inflation does not significantly respond to past inflation. Combining our findings of elevated attention levels with survey reports indicating that high costs of living are the top financial concern for many Americans⁶ suggests a highly persistent inflation regime, as described by Rudd (2022).

We briefly explore some of the empirical support for the hypothesis that current wage growth is correlated with past inflation and if this relationship appears stronger when attention to inflation is heightened. A number of recent papers have explored the joint dynamics of wages and inflation, e.g., Bernanke and Blanchard (2023) and Kamin and Roberts (2023). These models differ somewhat on the exact details, but share some common ingredients, which we use to explore the dynamics of wages. In particular, we use the simple framework where wage growth (Δw_t) is a function of past inflation ($\bar{\pi}_{t-1}$) and the tightness in the labor market (x_t)⁷:

$$\Delta w_t = \gamma_w \bar{\pi}_{t-1} + \kappa_w x_t + \epsilon_t \quad (3)$$

To estimate (3), for wage growth, we use monthly data from the Atlanta Fed Wage Growth Tracker on overall (unweighted) wage growth. For inflation, we use the same data as above to be consistent, and we use the 12-month lagged moving average to compute $\bar{\pi}_{t-1}$. There are many metrics of labor market tightness. Following Kamin and Roberts (2023), we use the difference between the unemployment rate and the noncyclical unemployment rate from the Congressional Budget Office.⁸

Results in column (1) of Table 2 highlight that lagged inflation is an important correlate with current wage growth (coefficient on lagged inflation is 0.341, p-value < 0.01).⁹ These results are similar in magnitude with those reported in Kamin and Roberts (2023).

Having established the correlation between current wage growth and past inflation, we are interested in exploring if attention towards inflation affects wages. In a second

⁶See the Gallup poll results <https://thehill.com/business/4638431-inflation-still-top-issue-financial-problems-gallup/> that report that this year is the third consecutive year that inflation has topped the list of financial concerns.

⁷Kamin and Roberts (2023), estimate a version of (3) with inflation expectations and find that expectations play minor role determining wage growth, as such we leave expectations out of our analysis.

⁸The baseline estimates of the correlation between wages and past inflation are quite similar if we use (v/u) as our measure of labor market tightness.

⁹As a robustness check, we also estimate the model with Newey-West standard errors (up to 6 lags) and the levels of significance are not impacted.

Table 2: Wage Regressions

Wage Growth	(1)	(2)
$\bar{\pi}_{t-1}$	0.341*** (0.035)	
$\bar{\pi}_{t-1}$ (High Attention)		0.435*** (0.024)
$\bar{\pi}_{t-1}$ (Low Attention)		0.181*** (0.044)
x_t	-0.329*** (0.060)	-0.212*** (0.018)
N	325	243

specification we estimate a threshold model where the relationship between wage growth and lagged inflation is possibly different when inflation attention (Google searches) is high. Results from this regression are reported in column (2). The estimated threshold where the relationship between wage growth and lagged inflation changes is a Google search index of 23, and we are able to reject the null hypothesis that the threshold model does not improve upon the simple linear model (p-value < 0.01). In the High Attention region (Google index above 23) the coefficient on lagged inflation is 0.435, which is more than double its value in the Low Attention region. Thus, the evidence is suggestive that when attention to inflation is high, wage growth is more strongly correlated with past inflation. This wage growth would naturally translate into higher future inflation.¹⁰

3 Conclusions

To summarise, we show evidence that in our current (early 2024) episode of disinflation, attention to inflation remains elevated. We show elevated attention across a number of countries, using different proxies for attention, and for a historical episode of disinflation in the U.S. We show two channels through which this heightened attention to inflation could increase inflation either via increasing inflation expectations or via increasing wages. Higher attention to inflation could rationalize the slower-than-expected disinflation experienced post-2022: while supply chain disruptions/demand shocks have faded, attention to inflation remains high and this translates into sustained wage growth as workers attempt to make up for higher living costs.

At a broader level, a classic concerns about high inflation is that it causes busi-

¹⁰See results in Bernanke and Blanchard (2023).

nesses/households to pay more attention to it. Normally, this concern relates to the un-anchoring of inflation expectations.¹¹ However, results from Bernanke and Blanchard (2023) suggest that inflation expectations did not become un-anchored post-2022. Rudd (2022) and our results highlight an alternative rationale for why heightened attention towards inflation is concerning: higher attention leads inflation to become more of a focal point in the wage bargaining process, which make inflation more persistent. This, of course, does not mean that the un-anchoring of expectations is never a concern. It is possible that if inflation gets high enough, the attention story acts more through the un-anchoring channel, but during the inflationary episode post-2020, our evidence suggests that the wage growth mechanism may be more relevant.

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¹¹“When inflation is persistently high, households and businesses must pay close attention and incorporate inflation into their economic decisions. When inflation is low and stable, they are freer to focus their attention elsewhere... Of course, inflation has just about everyone’s attention right now, which highlights a particular risk today: The longer the current bout of high inflation continues, the greater the chance that *expectations* of higher inflation will become entrenched” Powell (2022) (emphasis added).

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A Appendix: Additional Empirical Results

Figure A.1: Attention and Persistence (other countries)

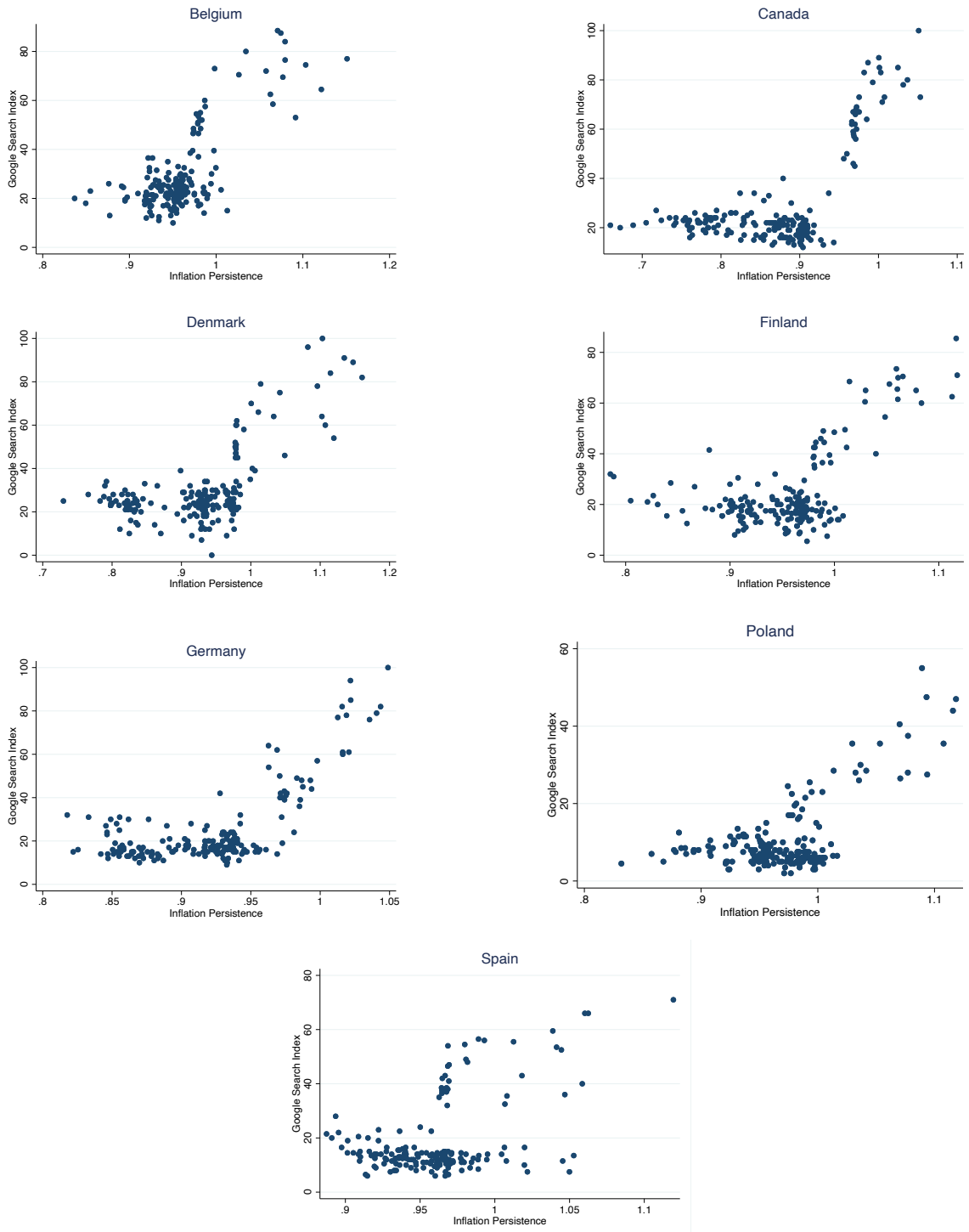


Figure A.2: Attention and Volatility (other countries)

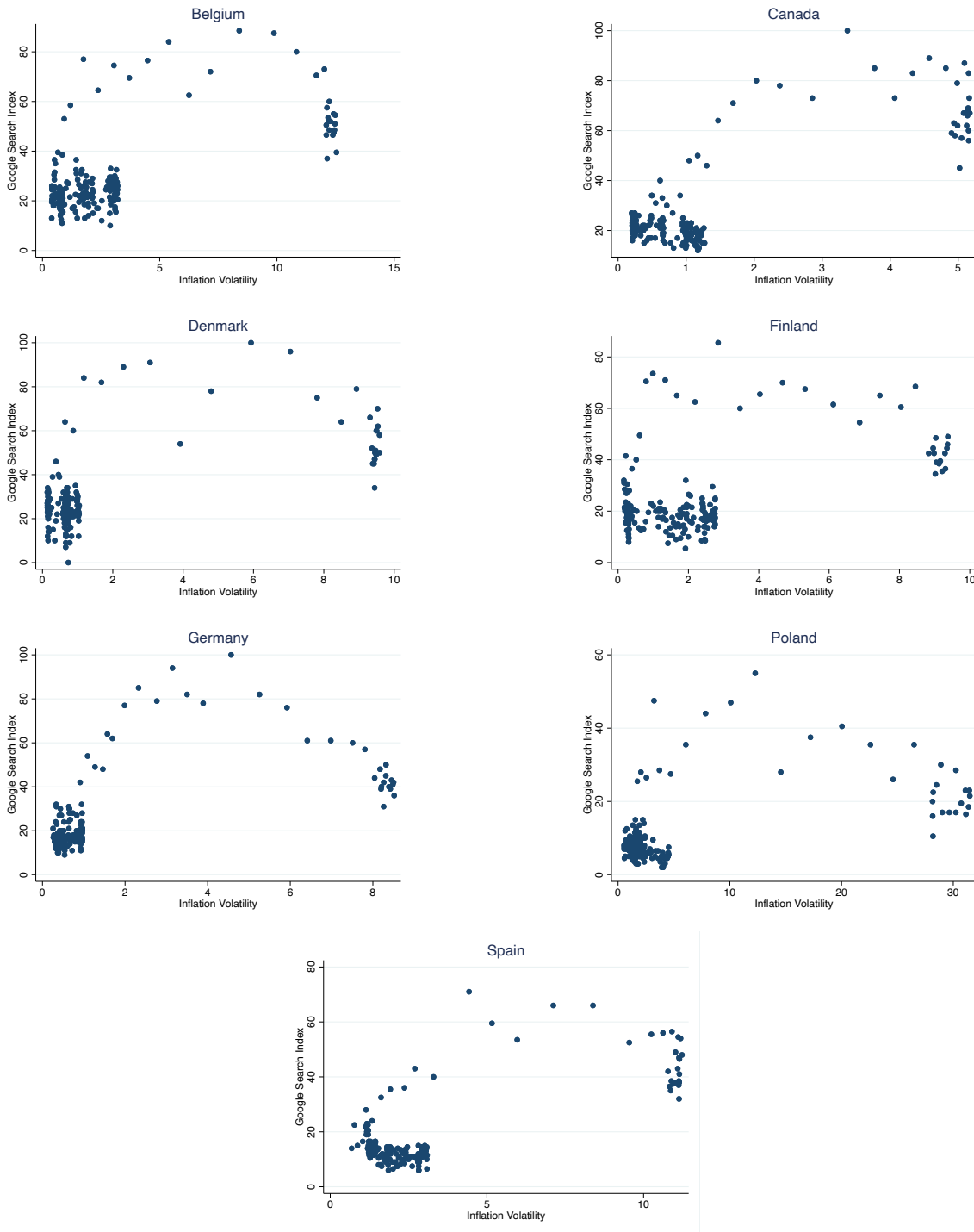


Figure A.3: Inflation persistence and volatility (other countries)

