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Does Experiencing High Inflation Change Economic Behavior?

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Introduction

For many years, most Americans rarely had to worry about inflation. The postpandemic era disrupted that experience, with elevated inflation impacting both households and businesses. Necessities—such as food, energy, housing, and other commonly purchased goods—became more expensive, and inflation entered everyday conversations. A growing academic literature shows that individual behavior can be shaped by the events people experience. The widespread experience of inflation raises an important question: Will living through this period of elevated inflation change economic behavior—and, if so, what does this mean for monetary policy?

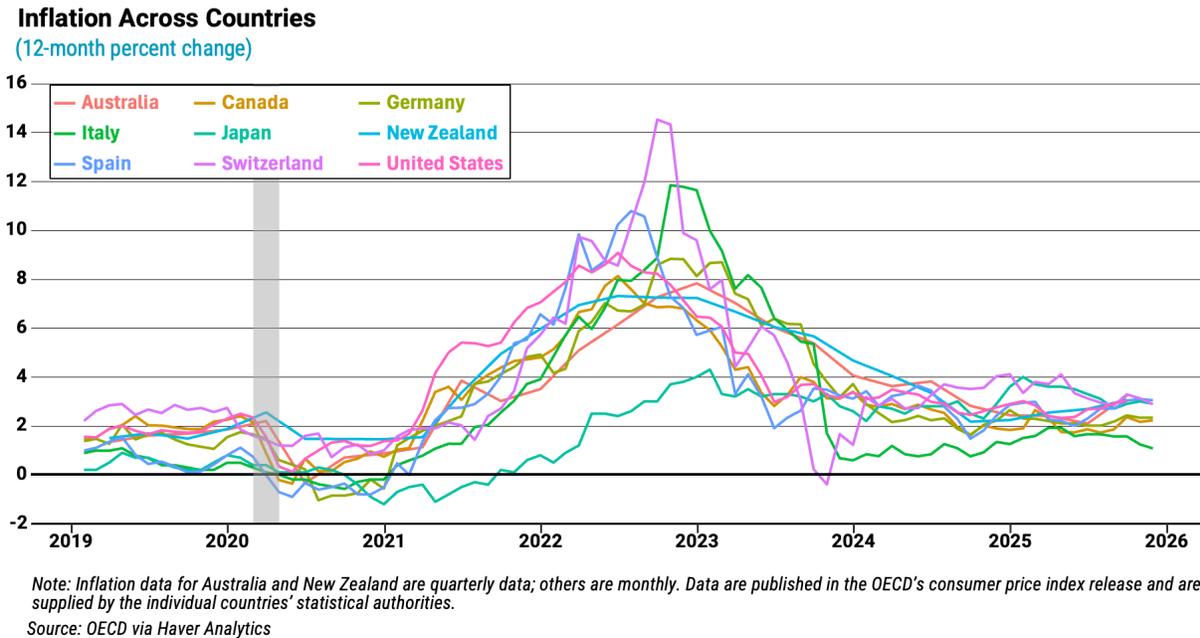
The Recent Global Experience of Inflation

During the pandemic, almost all advanced economies experienced a widespread surge in inflation (see Figure 1). This was true even though exposure to the coronavirus and the policy response varied significantly across countries. Elevated inflation occurred both in countries where unemployment rose sharply during the pandemic—such as the United States, Canada, Spain, and Italy—and in those where the effect on unemployment was relatively small, including Germany, the Netherlands, and Switzerland.² High inflation was observed in economies where the central bank has a single mandate to target inflation, such as the European Central Bank, Japan, and Switzerland as well as in countries with dual mandates aimed at achieving both price stability and strong labor markets, such as the United States, Australia, and New Zealand.

¹ The views expressed here are those of the authors and not necessarily those of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. The authors are grateful to Ben Henken for thoughtful comments and to Victoria Garcia and Omar Ahmad for excellent research assistance.

² Pandemic-related increases in unemployment occurred primarily in 2020, while most countries experienced elevated inflation primarily in 2022 and 2023. For most countries, unemployment had returned to or was trending toward normal levels by the time inflation was high.

Figure 1: Consumer Price Inflation Across Countries



Experience Shapes Behavior

We know that experience matters and has the potential to shape behavior. The field of psychology is based on the idea that many aspects of adult behavior are influenced by childhood experiences. There is growing evidence that experiences can similarly shape economic decision-making.

For example, Osili and Paulson (2008) show that immigrants who experienced institutions that are more protective of private property in their countries of origin are more likely to invest in the U.S. stock market. Building on that idea, Osili and Paulson (2014) find that immigrants who experienced a banking crisis in their country of origin are less likely to use bank accounts in the U.S. compared with otherwise similar immigrants who did not experience such a crisis. Additionally, Malmendier and Nagel (2011) show that individuals who have lived through periods of low stock market returns, such as during the Great Depression, exhibit investment behavior consistent with greater risk aversion. More recently, Malmendier and Shen (2024) find that consumers who experienced high unemployment during their prime working years spend less at a given income and wealth level than comparable individuals without such experience. Other researchers find a link between experiences and risk-taking behavior (Cameron and Shah, 2015) and the demand for insurance (Cai and Song, 2017).

Following the same logic, it is possible the period of elevated inflation following the pandemic could change the way firms set wages and prices. It may also affect the willingness of consumers to accept price increases or alter their investment decisions. To date, however, we do not have direct evidence that experiencing inflation has had a lasting impact on these behaviors.

However, researchers have shown that experiencing high inflation shapes the voting behavior and forecasts of the Federal Open Market Committee (FOMC) members. Members who have lived through higher inflation are more likely to vote for higher interest rates and make systematically higher inflation projections (Malmendier, Nagel, and Yan, 2021).

One channel through which experiencing high inflation might influence price and wage setting behavior is through its influence on inflation expectations. There is, in fact, a growing body of work showing just that.

Experience and Inflation Expectations

Malmendier and Nagel (2016) show that when forming expectations, individuals place more weight on the inflation they have personally experienced rather than considering the full historical record. Importantly, their work highlights that recent inflation has the strongest influence on expectations, potentially a key insight for understanding the potential effects of postpandemic inflation.

D'Acunto, Malmendier, Ospina, and Weber (2021) show that the specific prices people pay for their own groceries influence their inflation expectations. They also show that the frequency of purchase, rather than the expenditure share, matters most in determining which items influence inflation expectations. An implication of their work is that people will have different experiences of the same inflation episode, depending on what they actually buy and the frequency of their purchases.

What Are the Effects of the Recent Inflationary Experience?

One potential implication of the literature on experience and behavior is that the recent inflationary episode could cause people and firms to change their wage and price setting behavior. In addition, individuals may allocate less of their savings to assets like bank accounts and bonds that are more exposed to inflation risk and allocate more to assets such as stocks, real estate, and commodities. Teasing out how much recent asset price movements might have been affected by this force is a difficult question to answer that we leave for future researchers to tackle. Theory would also suggest that consumers would be more likely to spend, as opposed to save, if they believe prices are set to rise. Again, the extent to which current savings behavior is influenced by these factors is difficult to measure. We do, however, have direct measures of inflation

expectations, which are one important mechanism through which the experience of high inflation could influence consumer and firm decisions.

Is There Evidence That the Recent Inflationary Experience Has Changed Inflation Expectations?

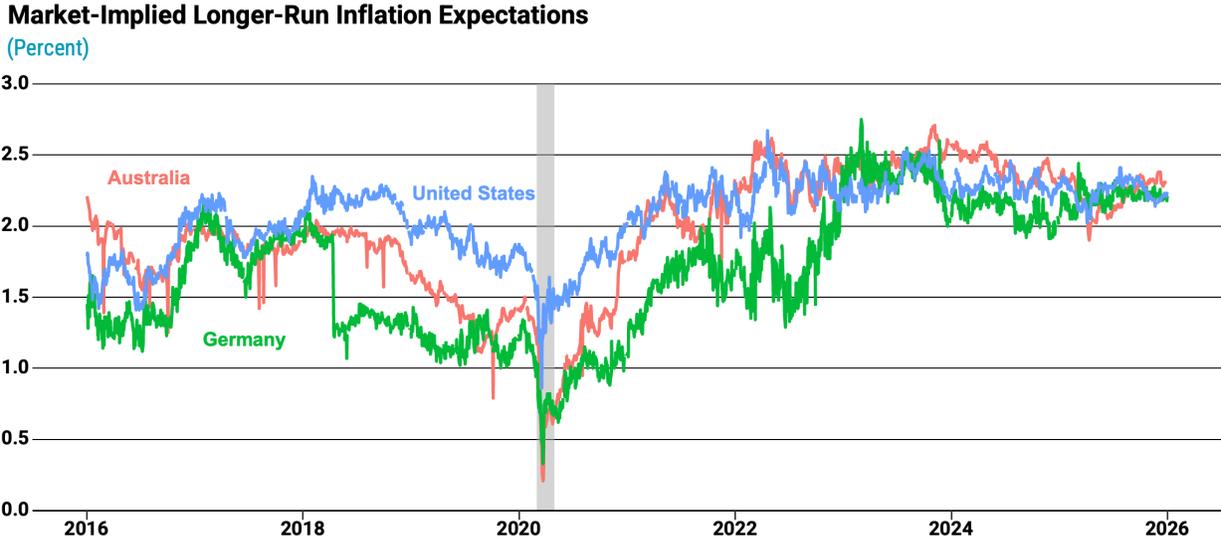
Survey evidence from the University of Michigan suggests consumer inflation expectations are indeed elevated at the one-year horizon: As of December 2025, the average one-year inflation forecast is 4.2 percent, which is roughly a percentage point above its average level in the years prior to the pandemic. The *Survey of Professional Forecasters (SPF)*, which polls economists and analysts, tells a similar story. So, at least for the near term, it does appear that inflation expectations are higher than they were before the pandemic. Of course, these measures likely capture more than just the experience of high inflation in the aftermath of the pandemic.

A more important question for monetary policymakers is whether long-term inflation expectations have changed. Here, the answer is no. The current market yields on Treasury Inflation-Protected Securities (TIPS) contracts imply that bond market participants expect U.S. CPI inflation to average around 2.2 percent over the five-year period that begins five years from now, which is consistent with the Fed's 2 percent inflation target (see Figure 2).³ The same is true for other major developed economies such as Germany and Australia (Figure 2). Survey evidence tells a similar story. For example, according to the University of Michigan's survey, average annual inflation over the next five years is expected to be 3.2 percent, only slightly above the 2.4 percent to 2.9 percent range that prevailed from 2010–2019, a period when the FOMC worried that inflation was a little too low. The SPF currently shows average annual inflation over the next 10 years is expected to be 2.4 percent, again only slightly higher than it was prior to the pandemic and consistent with the Fed's target.

Taken together, it appears that the inflation experience of the last five years has not left a lasting impact on long-run inflation expectations. Perhaps the unusual nature of the pandemic has led people to place less weight on this experience as a guide to the future. It is also consistent with central bank credibility and a belief that central banks will get inflation back to target. The remarkable stability of long-term inflation expectations throughout the period of elevated inflation (see Figure 2) suggests this view held even when inflation was at its peak.

³ The 2.2 percent number is as of 12/31/2025. TIPS contracts are based on headline CPI inflation, which is typically slightly higher than core PCE inflation, the measure targeted by the Fed. For example, between January 2007 and October 2025, the average gap between headline CPI and core PCE inflation was 0.4 percent.

Figure 2: Market-Implied Longer-Run Inflation Expectations



*Note: The U.S. and Germany are implied 5-year, 5-year forward rates. Australia is the implied expectation over the next 10 years.
Source: Deutsche Bundesbank, Federal Reserve Board, and Reserve Bank of Australia via Haver Analytics*

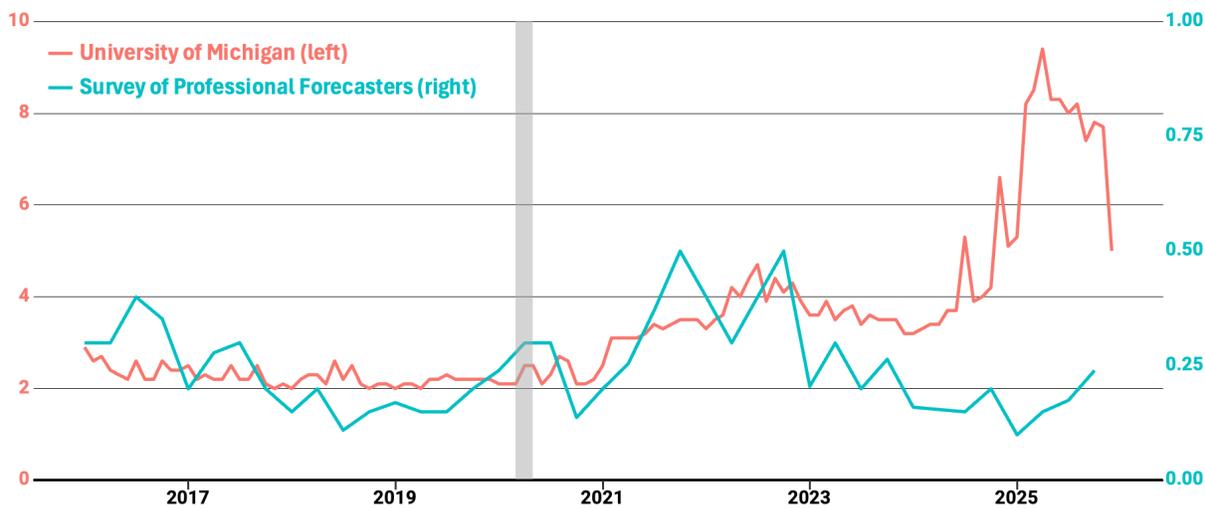
Despite this stability, there could still be greater dispersion in underlying inflation expectations because individuals experienced inflation differently depending on how their wages evolved and what they purchased. For example, in the early stages of the postpandemic recovery, goods inflation was especially elevated. This was especially true for motor vehicle prices in the U.S. People who needed to buy a car at the peak of motor vehicle inflation may expect greater future car price growth or expect the general level of inflation to be higher than other individuals.

So far, the survey evidence we have indicates that the dispersion of inflation expectations—measured by the difference in expectations between the 25th and 75th percentile of respondents—remains stable and around average historical levels for professional forecasters but is somewhat elevated for the individuals in the Michigan Survey (see Figure 3).

Figure 3: Dispersion of Inflation Expectations

Michigan and SPF Dispersion of Longer-Run Inflation Expectations

(Interquartile ranges in percentage points)



Sources: Federal Reserve Bank of Philadelphia and University of Michigan

Implications for Monetary Policy

The vast majority of individuals in the U.S. experienced low inflation, close to the FOMC's 2 percent target over the 35 years prior to the pandemic. Most individuals who did experience elevated inflation in the 1970s and early 1980s will also have lived through the Volcker recession. During this episode, the FOMC raised the federal funds rate as high as 20 percent in an effort to bring down inflation. This led to a recession in which the unemployment rate rose to 10 percent. This was a powerful demonstration of the FOMC's commitment to use monetary policy to curb inflation.

Since the Volcker era, developed countries' central banks have largely adopted explicit inflation targets and increased transparency, providing more information about the rationale for monetary policy actions. These institutional developments may play an important role in shaping experiences and behavior. For example, Osili and Paulson (2014) show that individuals who experienced a banking crisis in a country with deposit insurance had largely the same banking behavior as individuals from the same country who never experienced a banking crisis.

The literature also emphasizes that recent experiences often have the most impact on behavior. This underscores the importance of ensuring that inflation returns all the way to target. By doing so, monetary policymakers will deliver an experience that is likely to shape future expectations about central bank commitment to price stability. This can help keep long-run inflation expectations anchored and promote price stability. Price stability advances both economic efficiency and maximum employment by creating an

environment in which household and business decisions are not distorted by worries about inflation.

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