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The signalling content of asset prices for inflation: Implications for quantitative easing

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Highlights

- We investigate the signalling content of financial variables for episodes of low inflation/deflation and high inflation, respectively.
- We use both signalling extraction and logit modelling.
- The outcomes suggest that high asset prices more often signal high inflation than low inflation/deflation.
- However, in some cases high asset prices precede low inflation or deflation as well.
- These findings imply that the inflationary effects of stimulating asset prices through Quantitative Easing (QE) are uncertain.

Abstract

We investigate the information content of financial variables as signalling devices of two abnormal inflationary regimes: (1) low inflation or deflation, and (2) high inflation. Specifically, we determine the information content of equity and house prices, private credit volumes, and sovereign and corporate bond yields, for 11 advanced economies over the past three decades, using both signalling extraction and logit modelling. The outcomes show that high asset prices more often signal high inflation than low inflation/deflation. However, in some countries, high asset prices and low bond yields are a significant indicator of low inflation or deflation as well. The transmission time of financial developments to inflation can be quite long (up to 8 quarters). For monetary policy, these findings imply that stimulating asset prices through Quantitative Easing (QE) can effectively influence inflation, but that the effects are quite uncertain, both regarding timing and direction.

Keywords: Quantitative easing, Inflation, Financial markets

JEL classifications: E31, E44, E52

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