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## Measurement and characteristics of enterprise inflation expectations in Slovakia

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### Abstract

This article focuses on enterprise inflation expectations in Slovakia. Firstly, we propose a quantitative measure for enterprise inflation expectations based on results derived from the business tendency survey. The probability method (Carlson and Parkin method) is used for this purpose. Secondly, we proceed to test two specific models of enterprise inflation expectations formation in Slovakia – the rationality assumption model and the hybrid model assuming that inflation expectations can be partially forward-looking and partially backward-looking. Finally, we assess if the transmission of inflation expectations from one sector to another one can exist. Our analysis is conducted for companies operating in industry, construction, retail trade and services. Seasonally adjusted data from January 2002 (beginning of the business tendency surveys in Slovakia) to May 2015 are used, although some tests are done specifically for the post-euro introduction period (from January 2009).

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*Keywords:* inflation expectations; business tendency survey; probability method; rationality tests; inflation expectations transmission

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### 1. Introduction

Although various papers deal with inflation expectations (IE hereafter) of economic agents in different EMU member states (see for example Forsells and Kenny (2004) or Dias et al. (2010)), this field of research is less

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developed in Slovakia (see for example Zimková and Úradníček (2004) or Král' et al. (2007)). Other Central and Eastern European countries, which continue to perform their independent monetary policy outside the euro area, are motivated for IE testing because of a generally accepted postulate that they can represent leading indicator for monetary policies. This is true especially in the context of central banks willing to apply IE channel of monetary transmission mechanism to control inflation (e.g. Poland or Czech Republic). As the European Central Bank is also committed to a price-oriented monetary policy, complex knowledge about IE of various economic agents in all countries of the Eurozone, including Slovakia, is desirable.

Theoretical economists assume inflation expectations play an important role in the economy through their position in individual decision-making process of economic agents. For empirical economists, the study of IE formation on one side and their impact on current inflation on the other is of special interest. The assessment of the process of formation of IE is relevant for understanding how economic agents make decisions. In this context, rational expectations hypothesis introduced by Muth (1961) has received more attention in the literature. As being underlined by Dias et al. (2010), the rational expectations hypothesis has been subject to debate, which partly owes its existence to the inherent difficulties associated with testing a variable which is not easily measurable. Concerning research of the influence of IE on individual behavior of economic agents (and thus on actual inflation), the latter is examined specifically in current phase of business cycle - at time of zero lower bound period (see for example Bachman et al. (2015)). Our article tries to contribute to the first aspect of the role of IE in the economy. To do so, we firstly focus on possibilities of IE measurement in the context of Slovak economy. Afterwards, we analyse specific features of IE formation while testing their rationality and forward-lookingness. Finally, we put the mutual relationship between IE of economic agents in different economic sectors under question.

Traditionally, the empirical research of IE focuses on consumers for at least two reasons. Firstly, the impact of consumer IE on consumption behavior and wage formation (labour supply side) is an important issue in the economy (see for example Horeháková and Marasová (2014)). Secondly, the consumers IE are directly linked to the generally accepted measure of inflation rate such as year-on-year change of the consumer price index. However, enterprise IE can also represent an interesting reference value because of their possible impact on investment spending of companies or on wage formation (labour demand side). Thus, companies can not only influence, but also predict future inflation if we consider managers to be better-informed and/or better-experienced in macroeconomic forecasting (especially in the case of larger companies possessing the capacity for analysis of the macroeconomic environment of companies) than other groups of economic agents such as consumers. This condition depends on form of formation of IE of companies which is examined in our study.

## 2. Measurement of enterprise inflation expectations in Slovakia

In the absence of direct measures of enterprise IE in Slovakia - no survey proposing the quantitative data of expected inflation rate is available - some indirect measures can be applied. The surveys concerning the qualitative data about changes in price level which businesses in Slovakia anticipate are not provided on a regular basis (for instance in Poland, such a survey is undertaken quarterly by the National bank of Poland). However, the data from the Joint Harmonised EU Programme of Business Surveys are available in all EU member states, (including Slovakia). In this survey, the drawback of being purely qualitative data is compensated by their regularity, early availability and there being no necessity for revision.

In the framework of Business Tendency Survey (BTS hereafter) in Slovakia, there is one question regarding prices expectations which companies operating in different economic sectors, namely industry, construction, services and retail trade, are asked to answer: *Do you expect the prices you charge will rise/fall/stay unchanged in the following three months?* Thus, enterprises state their opinions about future development of prices concerning a very short period. This kind of research started in January 2002, so relatively long time series of seasonally adjusted data are available now.

Several doubts should be mentioned concerning the capacity of results of BTS to represent enterprise IE. Firstly, one can argue that the enterprises are not asked about their expectations concerning the future development of the general price level (external-type question) but about the prices of their products (internal-type question). However, the factors influencing the price strategies at the microeconomic level are close to those that can be eventually aggregated as factors responsible for inflation development at the macroeconomic level. In other words, an

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