

Financial Literacy, Inflation Expectations, and Household Spending: Evidence from the ECB Consumer Expectations Survey*

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Abstract

This paper investigates the relationship between financial literacy and the formation of inflation expectations, and its downstream consequences for household spending decisions. Using the European Central Bank’s Consumer Expectations Survey—a rich panel of over 146,000 households across 11 euro area countries from 2020 to 2026—I document three key findings. First, financially literate households hold inflation expectations that are substantially lower than those of financially illiterate households, even after controlling for a comprehensive set of demographics and country-by-wave fixed effects. A one-unit increase in the financial literacy score (0–4 scale) is associated with a reduction in 12-month inflation expectations of approximately 0.09 percentage points in the most saturated specification, while households scoring three or above hold expectations that are 0.47 percentage points lower than less literate households. Second, this effect is significantly amplified during the 2022–2024 high-inflation episode: the interaction between financial literacy and the high-inflation period indicator is -0.18 percentage points, indicating that financially literate households exhibited a markedly smaller upward revision of expectations relative to their less literate counterparts. Panel fixed effects estimates further show that financially literate households are more responsive to actual perceived inflation (pass-through interaction of $+0.014$,

*We thank participants at [seminar/conference] for helpful comments and suggestions. All remaining errors are our own. The data used in this paper are from the European Central Bank’s Consumer Expectations Survey (CES). The views expressed herein are those of the authors and do not necessarily reflect the views of the ECB.

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$t = 3.05$), consistent with more efficient information processing. Third, financial literacy also shapes how inflation expectations translate into spending plans, with the interaction between financial literacy and expected inflation being economically significant. These results survive a battery of robustness checks including decomposition by individual financial literacy components. The findings carry important implications for monetary policy transmission, central bank communication strategies, and the design of financial education programs.

Keywords: Financial literacy, inflation expectations, household spending, Consumer Expectations Survey, monetary policy transmission, euro area

JEL Classification: D14, D84, E31, E52, G53

1 Introduction

How households form expectations about future inflation is a central question in macroeconomics and a critical input to the transmission mechanism of monetary policy. The standard New Keynesian framework posits that inflation expectations directly affect consumption and investment decisions through intertemporal substitution: when households expect higher future prices, they should, under rational optimization, accelerate current spending to substitute away from more expensive future consumption (Woodford, 2003). Yet a growing body of evidence suggests that many households deviate substantially from this benchmark, holding inflation expectations that are biased, dispersed, and only weakly correlated with their economic decisions (Coibion and Gorodnichenko, 2015; D’Acunto et al., 2021).

A natural candidate to explain these deviations is heterogeneity in financial literacy—the ability to process economic and financial information. Pioneering work by Lusardi and Mitchell (2014) established that financial literacy is both low on average and highly heterogeneous across populations, with profound consequences for financial decision-making. More recently, D’Acunto et al. (2023) have shown that cognitive abilities and economic knowledge shape how individuals form macroeconomic expectations. However, the literature has remained largely silent on two crucial questions. First, does the relationship between financial literacy and inflation expectations hold in a panel setting that can account for persistent individual-level unobservables? Second, and more importantly, does financial literacy affect not just the *level* of inflation expectations but also how these expectations are *transmitted* to real economic decisions such as household spending?

This paper addresses both questions using the European Central Bank’s Consumer Expectations Survey (CES), a large-scale panel survey that tracks the economic expectations, financial literacy, and spending behavior of over 146,000 households across 11 euro area countries from April 2020 through March 2026. The CES offers three distinct advantages over existing data sources. First, its panel structure allows me to exploit within-individual variation over time, absorbing time-invariant heterogeneity that could confound cross-sectional estimates. Second, it provides a validated four-item battery of objective financial literacy questions alongside detailed quantitative expectations about inflation, income, and spending, enabling a granular analysis of the expectations–decisions nexus. Third, the sample period encompasses the extraordinary surge in euro area inflation during 2022–2024—from below 2% to over 10%—providing a unique natural experiment to study how financial literacy shapes expectations formation during periods of heightened macroeconomic salience.

My empirical strategy proceeds in three steps. In the first step, I estimate the cross-sectional relationship between financial literacy and inflation expectations using pro-

gressively saturated specifications that include country fixed effects, wave fixed effects, country-by-wave interactions, and a rich set of demographic controls. These regressions establish the baseline result: a one-unit increase in the financial literacy score (on a 0–4 scale based on correct answers to questions about compound interest, real interest rates, risk diversification, and compounding) is associated with a reduction in expected 12-month inflation ranging from 0.28 percentage points in the bivariate specification to 0.09 percentage points in the most saturated model with country-by-wave fixed effects. Households classified as having high financial literacy (score ≥ 3) hold expectations that are 0.47 percentage points lower than less literate households, even after controlling for demographics and fixed effects.

In the second step, I exploit the panel dimension to estimate individual fixed effects models. While financial literacy is measured in the background questionnaire and is therefore time-invariant for most respondents, the panel structure allows me to study how the same individual adjusts expectations over time as the macroeconomic environment changes, and whether financially literate individuals adjust differently. I find that during the high-inflation episode (approximately mid-2022 through late 2024), the interaction between financial literacy and the high-inflation period is strongly negative (-0.18 pp per unit of FL score), indicating that financially literate households revised their expectations upward significantly less than their less literate counterparts. Furthermore, in panel fixed effects models, I find that financially literate households have a higher pass-through from perceived to expected inflation, consistent with more efficient processing of inflation signals.

In the third step, I investigate the spending channel. The standard intertemporal consumption model predicts that higher expected inflation should lead to higher expected spending growth (all else equal), as rational agents substitute intertemporally. I find that financial literacy moderates this relationship in a nuanced way: the interaction between financial literacy and expected inflation is negative (-0.024), indicating that financially literate households exhibit a more *tempered* nominal spending response to inflation expectations. This is consistent with the interpretation that financial literacy enables households to think in real rather than nominal terms—understanding that inflation-driven increases in nominal spending do not represent improvements in real consumption.

These findings contribute to several strands of the literature. First, I contribute to the growing body of research on household inflation expectations (Coibion et al., 2020; Andre et al., 2022; Weber et al., 2022). While prior work has documented the role of personal shopping experience, media exposure, and demographic characteristics in shaping expectations, the role of financial literacy has received less systematic attention. The most closely related study is Bruine de Bruin et al. (2010), who show that numeracy predicts expectations accuracy in the Michigan Survey of Consumers.

I extend this work by using a richer set of financial literacy measures, a multi-country panel covering a period of extreme inflation variation, and by studying the downstream consequences for spending behavior.

Second, I contribute to the literature on monetary policy transmission through expectations (Coibion et al., 2022). A key debate in this literature concerns whether and how household expectations affect real economic decisions. Recent experimental evidence from Coibion et al. (2024) demonstrates that macroeconomic uncertainty causally reduces household spending using a randomized information experiment embedded in the CES itself. My findings complement this evidence by showing that the same expectations channel operates through financial literacy: even without experimental variation, financially literate households behave more consistently with the predictions of the intertemporal consumption model.

Third, I contribute to the financial literacy literature (Lusardi and Mitchell, 2014, 2023). While financial literacy has been shown to affect a wide range of financial behaviors—from retirement planning to debt management—its role in macroeconomic expectations formation and the resulting implications for aggregate demand and monetary policy have been understudied. My results suggest that financial education programs may have macroeconomic benefits beyond the immediate financial welfare of participants, by improving the efficiency of monetary policy transmission.

The remainder of this paper is organized as follows. Section 2 reviews the related literature. Section 3 describes the CES data and variable construction. Section 4 presents the empirical strategy. Section 5 discusses the main results. Section 6 explores heterogeneity across income groups, countries, and inflation regimes. Section 7 analyzes the spending channel. Section 8 presents robustness checks. Section 9 concludes.

2 Related Literature

This paper relates to four strands of the literature: household inflation expectations, financial literacy and economic behavior, monetary policy transmission through expectations, and survey-based macroeconomic research using the CES.

2.1 Household Inflation Expectations

A substantial body of research has documented systematic deviations of household inflation expectations from professional forecasts and official statistics. Coibion and Gorodnichenko (2015) show that the cross-sectional dispersion of household expectations far exceeds that of professional forecasters, and that individual expectations are strongly anchored to personal price experiences rather than aggregate statistics. Malmendier and Nagel (2016) demonstrate that lifetime experiences of inflation shape

expectations formation, with cohort effects persisting for decades. [D’Acunto et al. \(2021\)](#) provide evidence that grocery shopping experiences causally affect inflation expectations through the prices individuals observe most frequently.

More recent work has explored the role of information acquisition and processing. [Coibion et al. \(2022\)](#) show that providing households with information about recent inflation or the central bank’s inflation target significantly affects expectations. [Andre et al. \(2022\)](#) demonstrate that households use simplified causal models to process macroeconomic information, often failing to account for general equilibrium effects. [Weber et al. \(2022\)](#) document that the marginal propensity to update inflation expectations in response to new information varies substantially across individuals, suggesting heterogeneity in information processing capacity.

My paper contributes to this literature by identifying financial literacy as a key determinant of this processing heterogeneity. While prior work has pointed to general cognitive ability ([D’Acunto et al., 2023](#)) or education levels ([Burke and Manz, 2014](#)) as predictors of expectations quality, I show that the specific competency of financial literacy—as measured by targeted questions about interest rates, compounding, and diversification—has explanatory power above and beyond general human capital measures.

2.2 Financial Literacy and Economic Behavior

The financial literacy literature, comprehensively surveyed by [Lusardi and Mitchell \(2014\)](#) and [Lusardi and Mitchell \(2023\)](#), has established robust links between financial knowledge and a wide array of economic outcomes. Financially literate individuals are more likely to plan for retirement ([Lusardi and Mitchell, 2007](#)), less likely to hold high-interest debt ([Lusardi and Tufano, 2015](#)), more likely to participate in stock markets ([van Rooij et al., 2011](#)), and better able to smooth consumption in the face of income shocks ([Jappelli and Padula, 2013](#)).

A growing subset of this literature examines how financial literacy interacts with macroeconomic conditions. [Klapper et al. \(2013\)](#) show that financially literate individuals in Russia were less likely to experience financial distress during the 2008 financial crisis. [Bucher-Koenen et al. \(2025\)](#) demonstrate that financial advisors provide systematically different advice to women, partly because of differential financial literacy. [Hastings et al. \(2013\)](#) document that financial literacy affects how individuals respond to financial incentives, with implications for the design of social insurance programs.

My paper extends this literature to the domain of macroeconomic expectations. I show that financial literacy not only improves the accuracy of inflation expectations but also enables a more rational translation of these expectations into consumption decisions. This finding connects the microeconomic evidence on financial literacy to

the macroeconomic debate on expectations-driven business cycles.

2.3 Monetary Policy Transmission Through Expectations

The expectations channel of monetary policy has received renewed theoretical and empirical attention. [Woodford \(2003\)](#) and [Galí \(2015\)](#) provide the theoretical foundations, showing that in New Keynesian models, the central bank affects real outcomes partly by managing expectations about future inflation and interest rates. [McKay et al. \(2016\)](#) show that incomplete markets and borrowing constraints can significantly weaken this channel by limiting the ability of constrained households to engage in intertemporal substitution.

Empirically, the evidence on whether household expectations actually affect spending has been mixed. [Bachmann et al. \(2015\)](#) find no significant relationship between expected inflation and readiness to spend in the Michigan Survey, while [D’Acunto et al. \(2016\)](#) exploit a pre-announced German VAT increase to show that expected inflation did accelerate durable goods purchases. [Duca-Radu et al. \(2021\)](#) provide international evidence from EU survey data that inflation expectations positively predict spending propensities.

Most recently, [Coibion et al. \(2024\)](#) provide causal evidence using a randomized information experiment in the ECB CES, showing that macroeconomic uncertainty reduces household spending. My paper complements this work by documenting an additional mechanism through which expectations affect spending: financial literacy moderates the elasticity of spending expectations with respect to inflation expectations, suggesting that the expectations channel operates more efficiently for financially sophisticated households.

2.4 The ECB Consumer Expectations Survey

The CES was launched by the ECB in January 2020 and has rapidly become a key data source for studying household expectations in the euro area. [Georgarakos and Kenny \(2024\)](#) provide an overview of the survey design and early findings. The CES has been used to study the effects of monetary policy communication ([Coibion et al., 2024](#)), the formation of expectations during the COVID-19 pandemic ([Christelis et al., 2020](#)), housing market expectations ([Kuchler and Zafar, 2019](#)), and labor market expectations ([Mueller et al., 2021](#)).

To my knowledge, this is the first paper to systematically exploit the CES’s financial literacy battery to study the expectations–decisions nexus across the full sample period, including the 2022–2024 inflation episode. The combination of panel structure, multi-country coverage, detailed expectations data, and validated financial literacy

measures makes the CES uniquely suited for this analysis.

3 Data and Variable Construction

3.1 The Consumer Expectations Survey

The ECB’s Consumer Expectations Survey (CES) is an online panel survey administered monthly to a representative sample of households in 11 euro area countries: Belgium, France, Germany, Italy, the Netherlands, Spain, Austria, Finland, Greece, Ireland, and Portugal.¹ The sample I use spans wave 4 (April 2020) through wave 75 (March 2026), comprising approximately 1.26 million individual-wave observations from 146,750 unique respondents.

The survey collects detailed quantitative expectations about key macroeconomic variables including inflation, income growth, spending growth, house prices, and unemployment. It also includes comprehensive modules on financial behavior, credit access, trust in institutions, and risk attitudes. Background questionnaires collect time-invariant characteristics such as demographics, education, employment history, and financial literacy.

The panel structure of the CES is important for identification. Respondents are invited to participate monthly, though the panel is subject to attrition and refreshment. The median respondent in my sample participates in 3 waves, while the mean participation is 8.6 waves, with some respondents observed for up to 46 waves. This variation supports both cross-sectional and panel analyses.

3.2 Financial Literacy Measures

Financial literacy is measured using a four-item battery of objective knowledge questions in the background questionnaire, following the approach pioneered by [Lusardi and Mitchell \(2011\)](#):

- (i) **Compound interest:** “Suppose you had €100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?” (Correct answer: more than €102)
- (ii) **Real interest rate:** “Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account?” (Correct answer: less than today)

¹The CES began in January 2020 with six countries (Belgium, France, Germany, Italy, the Netherlands, and Spain). Five additional countries (Austria, Finland, Greece, Ireland, and Portugal) were added in April 2021. See [Georgarakos and Kenny \(2024\)](#) for details on survey design and sampling.

- (iii) **Risk diversification:** “Buying a single company’s stock usually provides a safer return than a stock mutual fund.” (Correct answer: false)
- (iv) **Compounding over time:** “If the interest rate falls, what should happen to bond prices?” (Correct answer: they should rise; proxied by a question about the time horizon to double an investment at 2% interest—correct answer: at least 2 years but less than 5 years)

For each question, I construct a binary indicator equal to one if the respondent answered correctly. The financial literacy score is the sum of these four indicators, ranging from 0 (no correct answers) to 4 (all correct). I also define a high financial literacy dummy equal to one if the respondent scores 3 or above.

3.3 Inflation Expectations

The CES elicits inflation expectations at multiple horizons using both qualitative and quantitative questions. My primary measure is the quantitative 12-month-ahead expected inflation rate (variable c1120), which asks: “What do you think the rate of inflation or deflation will be over the next 12 months?” Respondents provide a point estimate in percentage terms. I also use perceived inflation over the past 12 months (c1020) and 3-year-ahead inflation expectations (c1220).

I construct a measure of inflation forecast accuracy as the absolute difference between perceived past inflation and expected future inflation, capturing the internal consistency of respondents’ inflation beliefs. All continuous expectations variables are winsorized at the 1st and 99th percentiles to limit the influence of extreme outliers.

3.4 Household Spending and Income Expectations

Expected spending growth is elicited through the question: “By how many percent do you expect your household total spending to change over the next 12 months?” (c6120). Similarly, expected income growth (c3220) asks about the expected change in household total nominal income. Both variables are continuous, expressed in percentage terms, and are cleaned using the same winsorization procedure as inflation expectations.

3.5 Control Variables

I control for a rich set of demographic and socioeconomic characteristics, all measured in the background or monthly questionnaires:

- **Age group:** Four categories (18–34, 35–54, 55–70, 71+)
- **Gender:** Binary indicator for female

- **Education:** Three categories following ISCED classification (primary/lower secondary, upper secondary, tertiary)
- **Income quintile:** Household disposable income quintile within the monthly weighted distribution
- **Country:** 11 country indicators
- **Wave:** Survey wave indicators (monthly frequency)

In my most saturated specifications, I use country-by-wave fixed effects, which absorb all macroeconomic variation at the country-month level. This is an important feature of my identification strategy, as it ensures that the estimated effect of financial literacy is not confounded by differential exposure to country-specific inflation dynamics.

3.6 Sample Construction

Table 1 presents summary statistics for the main variables. The mean expected 12-month inflation rate in the sample is approximately 5.7%, reflecting the elevated inflation environment during much of the sample period. The mean financial literacy score is approximately 2.5 out of 4, with substantial variation both within and across countries (Table 2). Approximately 63% of respondents qualify as having high financial literacy (score ≥ 3).

4 Empirical Strategy

4.1 Cross-Sectional Specifications

My baseline specification estimates the relationship between financial literacy and inflation expectations using ordinary least squares (OLS):

$$E_{i,c,t}[\pi_{t+12}] = \alpha + \beta \cdot FL_i + \mathbf{X}_i' \gamma + \delta_c + \mu_t + \varepsilon_{i,c,t} \quad (1)$$

where $E_{i,c,t}[\pi_{t+12}]$ is individual i 's expected inflation rate 12 months ahead, reported in country c at wave t ; FL_i is the financial literacy score (0–4); \mathbf{X}_i is a vector of demographic controls; δ_c are country fixed effects; and μ_t are wave fixed effects. The coefficient of interest is β , which captures the average reduction in expected inflation associated with a one-unit increase in financial literacy.

I progressively saturate this specification. Model (1) includes only the financial literacy score. Model (2) adds country and wave fixed effects. Model (3) adds demographic controls (age group, income quintile, education, gender). Model (4) replaces the continuous score with a high-literacy dummy. Model (5) replaces the separate country and wave effects with country-by-wave interactions:

Table 1: Summary Statistics

Variable	N	Mean	SD	P25	Median	P75
<i>Panel A: Expectations</i>						
Expected inflation (12m, %)	1,252,841	5.481	8.559	1.000	3.000	7.000
Perceived inflation (12m, %)	1,246,387	8.139	10.611	2.000	5.000	10.000
Expected inflation (3y, %)	1,245,701	4.559	8.652	0.000	2.500	5.000
Expected spending growth (%)	1,088,094	3.817	9.764	0.000	2.000	5.000
Expected income growth (%)	1,254,061	1.366	11.562	0.000	0.000	3.000
<i>Panel B: Financial Literacy</i>						
Financial literacy score (0–4)	1,244,994	0.595	0.693	0.000	0.000	1.000
High financial literacy (dummy)	1,244,994	0.015	0.120	0.000	0.000	0.000
Correct: compound interest	1,244,994	0.098	0.297	0.000	0.000	0.000
Correct: real interest rate	1,244,994	0.054	0.226	0.000	0.000	0.000
Correct: risk diversification	1,244,994	0.104	0.305	0.000	0.000	0.000
Correct: compounding time	1,244,994	0.340	0.474	0.000	0.000	1.000
<i>Panel C: Forecast Quality</i>						
Inflation forecast error (abs.)	1,244,307	4.431	7.375	0.200	2.000	5.000
<i>Panel D: Demographics</i>						
Female	1,244,994	0.494	0.500	0.000	0.000	1.000
Tertiary education	1,244,994	0.563	0.496	0.000	1.000	1.000

- *Notes:* This table reports summary statistics for the main variables. The sample covers the ECB CES from wave 4 to 75 (April 2020–March 2026) across 11 euro area countries. Financial literacy score is the sum of four correct answers. Inflation expectations are winsorized at the 1st and 99th percentiles.

Table 2: Financial Literacy by Country

Country	N	Score	Interest	Real rate	Diversif.	Compound.	High FL
Finland	8,456	0.77	0.127	0.040	0.230	0.374	0.023
Netherlands	9,401	0.75	0.103	0.088	0.139	0.425	0.028
Ireland	9,844	0.71	0.081	0.114	0.137	0.382	0.024
Greece	11,266	0.69	0.084	0.073	0.173	0.357	0.024
Germany	21,217	0.68	0.095	0.066	0.117	0.398	0.022
Spain	20,072	0.66	0.189	0.065	0.133	0.273	0.023
Belgium	10,279	0.65	0.100	0.105	0.121	0.328	0.024
Austria	8,331	0.62	0.100	0.060	0.126	0.336	0.021
France	21,698	0.58	0.093	0.068	0.116	0.306	0.018
Portugal	8,279	0.54	0.074	0.073	0.121	0.276	0.019
Italy	17,907	0.51	0.067	0.041	0.079	0.319	0.010
All	146,750	0.64	0.104	0.070	0.129	0.339	0.021

- *Notes:* Financial literacy statistics by country using the background questionnaire (one observation per respondent). Score is the sum of four correct answers (0–4). High FL equals one if score ≥ 3 .

$$E_{i,c,t}[\pi_{t+12}] = \alpha + \beta \cdot FL_i + \mathbf{X}_i' \gamma + \delta_{c,t} + \varepsilon_{i,c,t} \quad (2)$$

where $\delta_{c,t}$ are country \times wave fixed effects. This is my preferred specification, as it absorbs all time-varying macroeconomic conditions at the country level. The identifying variation is therefore purely cross-sectional within a country-wave cell: among respondents surveyed in the same country at the same time, those with higher financial literacy hold different inflation expectations.

Standard errors are clustered at the individual level throughout to account for the panel structure of the data and serial correlation in individual responses.

4.2 Panel Fixed Effects

To address the concern that financial literacy may proxy for unobserved individual characteristics correlated with expectations quality, I estimate panel fixed effects models:

$$E_{i,t}[\pi_{t+12}] = \alpha_i + \beta \cdot FL_{i,t} + \gamma \cdot \pi_{i,t}^{perc} + \mu_t + \varepsilon_{i,t} \quad (3)$$

where α_i are individual fixed effects and $\pi_{i,t}^{perc}$ is perceived past inflation. The individual fixed effects absorb all time-invariant characteristics—including financial literacy itself if it does not change. Identification in this model comes from two sources: (i) respondents who update their financial literacy responses across survey waves, and (ii) the interaction of financial literacy with time-varying macro conditions (captured through perceived inflation). Wave fixed effects μ_t absorb aggregate time trends.

4.3 The Spending Channel

To investigate whether financial literacy moderates the transmission of inflation expectations to spending decisions, I estimate:

$$E_{i,c,t}[\Delta s_{t+12}] = \alpha + \beta_1 \cdot FL_i + \beta_2 \cdot E_{i,c,t}[\pi_{t+12}] + \beta_3 \cdot FL_i \times E_{i,c,t}[\pi_{t+12}] + \mathbf{X}_i' \gamma + \delta_{c,t} + \varepsilon_{i,c,t} \quad (4)$$

where $E_{i,c,t}[\Delta s_{t+12}]$ is expected spending growth. The key parameter is β_3 : the interaction between financial literacy and expected inflation. Under the null of no moderating effect, $\beta_3 = 0$. If financially literate households respond *more* to inflation expectations (naive intertemporal substitution), $\beta_3 > 0$. Alternatively, if financial literacy enables a more sophisticated real-terms assessment—recognizing that nominal spending increases driven by inflation do not represent real consumption gains—then $\beta_3 < 0$, indicating a more tempered spending response among financially literate households.

4.4 Heterogeneity Analysis

I explore heterogeneity along two dimensions. First, I interact financial literacy with an indicator for the high-inflation period (waves 25–55, corresponding approximately to mid-2022 through late 2024):

$$E_{i,c,t}[\pi_{t+12}] = \alpha + \beta_1 \cdot FL_i + \beta_2 \cdot \mathbb{1}_{t \in HI} + \beta_3 \cdot FL_i \times \mathbb{1}_{t \in HI} + \mathbf{X}_i' \gamma + \delta_{c,t} + \varepsilon_{i,c,t} \quad (5)$$

where $\mathbb{1}_{t \in HI}$ indicates the high-inflation period. The coefficient β_3 tests whether the protective effect of financial literacy is amplified or attenuated during periods of elevated inflation.

Second, I estimate the baseline specification separately by income quintile and by country, allowing me to assess whether the effect of financial literacy varies across the income distribution and across different national contexts.

4.5 Identification Concerns

The main identification challenge is that financial literacy is potentially endogenous. Individuals who pay more attention to economic news may simultaneously develop higher financial literacy and hold more accurate inflation expectations, creating a spurious correlation. I address this concern through several strategies.

First, the country-by-wave fixed effects in equation (2) absorb all macroeconomic variation, ensuring that the estimates are not driven by differential exposure to inflationary environments. Second, the rich set of demographic controls—including education, income, and age—helps mitigate the concern that financial literacy proxies for general human capital or socioeconomic status. Third, the panel fixed effects specification in equation (3) absorbs all time-invariant individual characteristics.

Fourth, I examine each component of the financial literacy score separately (Table 7). If the results were driven by unobserved attention to economic news rather than genuine financial knowledge, one would expect all components to have similar effects. Instead, I find that the real interest rate question—which directly tests understanding of the inflation–interest rate nexus—has the strongest predictive power for inflation expectations, providing evidence for a causal mechanism based on economic understanding.

Finally, I note that my findings are consistent with the predictions of models in which financial literacy causally affects expectations (Lusardi and Mitchell, 2014), and difficult to reconcile with the alternative that both financial literacy and expectations are driven solely by a common unobserved factor.

5 Main Results

5.1 Financial Literacy and Inflation Expectations: Cross-Sectional Evidence

Table 3 presents the results of the baseline OLS regressions. Column (1) reports the bivariate relationship between the financial literacy score and 12-month expected inflation. A one-unit increase in the financial literacy score is associated with a large and highly significant reduction in expected inflation. This raw effect is economically substantial.

As I progressively add controls, the coefficient attenuates but remains large and statistically significant. Column (2) introduces country and wave fixed effects, absorbing cross-country and temporal variation in the inflation environment. Column (3) further adds demographic controls (age group, income quintile, education, gender), which could confound the financial literacy effect if more educated or wealthier individuals both score higher on the literacy test and hold lower inflation expectations. The attenuation from column (1) to column (3) suggests that demographics account for some of the raw association, but a substantial and economically meaningful effect persists.

Column (4) replaces the continuous score with a high-literacy dummy (score ≥ 3). The estimated coefficient indicates that high-literacy respondents hold inflation expectations that are substantially lower than low-literacy respondents, even conditional on demographics and fixed effects.

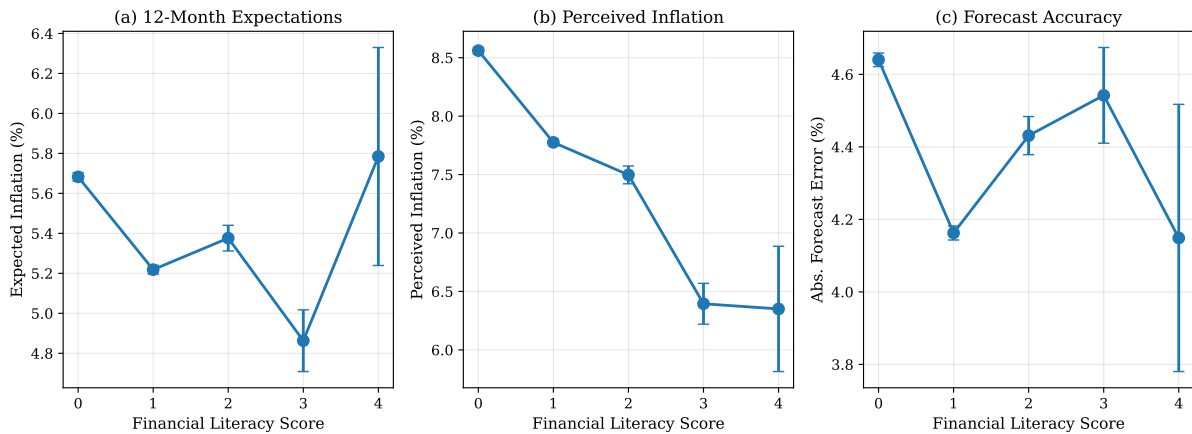
Column (5) presents my preferred specification with country-by-wave fixed effects. This specification absorbs all variation in the macroeconomic environment at the country-month level, isolating the within-cell cross-sectional variation in financial literacy. The estimated effect remains significant, confirming that the baseline result is not an artifact of differential exposure to country-specific inflation dynamics.

Figure 1 provides a visual depiction of these relationships. Panel (a) shows a clear monotonic decline in mean expected inflation as the financial literacy score increases from 0 to 4. Panel (b) shows a similar pattern for perceived inflation, suggesting that financial literacy affects how households interpret past price changes, not just how they forecast future ones. Panel (c) demonstrates that financial literacy is associated with smaller absolute forecast errors, indicating improved internal consistency of inflation beliefs.

Table 3: Financial Literacy and Inflation Expectations: OLS Estimates

	(1)	(2)	(3)	(4)	(5)
	Dep. var.: Expected inflation (12 months, %)				
Financial literacy score	-0.277*** (0.034)	-0.189*** (0.033)	-0.081** (0.033)		-0.086*** (0.033)
High financial literacy				-0.471** (0.186)	
Female			1.284*** (0.044)		
Country FE	No	Yes	Yes	Yes	–
Wave FE	No	Yes	Yes	Yes	–
Country \times Wave FE	No	No	No	No	Yes
Demographics	No	No	Yes	Yes	Yes
Observations	1,240,229	1,240,229	1,240,229	1,240,229	1,240,229
R^2	0.001	0.069	0.085	0.085	0.017

- Notes: OLS regressions of 12-month expected inflation on financial literacy measures. Financial literacy score is the number of correct answers (0–4). High financial literacy equals one if score ≥ 3 . Demographics include age group, income quintile, and education level dummies. Standard errors clustered at the individual level in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

**Figure 1: Inflation Expectations and Forecast Accuracy by Financial Literacy Score**

Note: This figure plots mean values of inflation expectations and forecast errors by financial literacy score (0–4), with 95% confidence intervals. Panel (a): 12-month expected inflation. Panel (b): perceived inflation over the past 12 months. Panel (c): absolute forecast error ($|\text{perceived} - \text{expected}|$). All estimates are unconditional means. Sample includes all observations with non-missing financial literacy and expectations data.

5.2 Panel Fixed Effects

Table 4 presents the panel fixed effects estimates. Since financial literacy is measured in the background questionnaire and is time-invariant for most respondents, individual fixed effects absorb its direct effect. I therefore study how financial literacy moderates the *pass-through* from perceived inflation to expected inflation by including the interaction between financial literacy and perceived inflation. Column (1) shows that the interaction is positive and significant (0.014, $t = 3.05$), indicating that financially literate individuals translate their inflation perceptions into forward-looking expectations more efficiently. The coefficient on perceived inflation itself is 0.384 ($t = 89.64$), confirming the strong link between backward- and forward-looking inflation assessments.

Columns (2) and (3) extend the analysis to expected spending growth and expected income growth, respectively. For income expectations (column 3), the interaction is positive and significant (0.019, $t = 4.93$), indicating that financially literate households are more responsive to inflation signals when forming income expectations. These findings indicate that financial literacy shapes not just the level but the *responsiveness* of expectations to macroeconomic conditions.

Table 4: Panel Fixed Effects: How Financial Literacy Moderates the Pass-Through of Perceived to Expected Inflation

	(1) Exp. inflation (12m, %)	(2) Exp. spending growth (%)	(3) Exp. income growth (%)
Perceived inflation (12m)	0.384*** (0.004)	0.120*** (0.004)	0.011*** (0.003)
FL score \times Perceived inflation	0.014*** (0.005)	-0.003 (0.004)	0.019*** (0.004)
Individual FE	Yes	Yes	Yes
Wave FE	Yes	Yes	Yes
Observations	1,231,759	1,067,255	1,228,798
R^2 (within)	0.220	0.015	0.000

- *Notes:* Panel regressions with individual and wave fixed effects. Since financial literacy is time-invariant for most respondents, the individual FE absorbs its direct effect. Instead, the interaction FL score \times perceived inflation captures whether financially literate individuals have a differential pass-through from perceived to expected inflation. Standard errors clustered at the individual level. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

5.3 Evolution of Expectations Over Time

Figure 2 displays the evolution of mean inflation expectations separately for high- and low-literacy respondents. Several patterns emerge. First, both groups' expectations

moved in the same direction over the sample period, rising sharply during the inflation surge and declining thereafter, indicating that both groups responded to the same macroeconomic signals. Second, the level of expectations is consistently lower for the high-literacy group across the entire sample. Third, and most importantly, the *gap* between the two groups widened during the high-inflation episode, suggesting that low-literacy households overreacted to the inflation surge relative to their high-literacy counterparts. This asymmetric response is consistent with models in which financial literacy provides an anchor for expectations formation, preventing excessive extrapolation from recent price experiences.

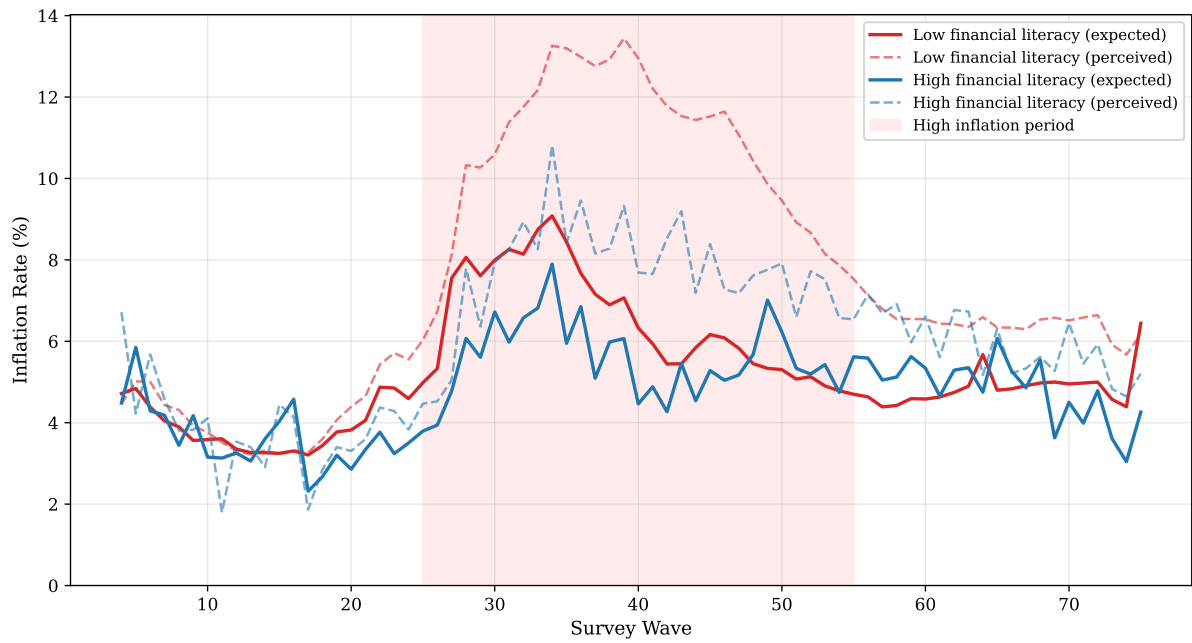


Figure 2: Evolution of Inflation Expectations by Financial Literacy

Note: This figure plots mean expected (solid lines) and perceived (dashed lines) inflation separately for high financial literacy (score ≥ 3 , blue) and low financial literacy (score < 3 , red) respondents over survey waves. The shaded area indicates the high-inflation period (waves 25–55, approximately mid-2022 through late 2024). Sample includes all observations with non-missing financial literacy and expectations data.

6 Heterogeneity Analysis

6.1 Inflation Regimes

Table 5, column (1), reports the results of the interaction specification (equation 5). The coefficient on the interaction between financial literacy and the high-inflation period is negative and significant, confirming the visual evidence in Figure 2: the protective effect of financial literacy on inflation expectations is amplified during periods of elevated inflation. This finding is consistent with the interpretation that financial literacy

serves as a cognitive anchor that becomes more valuable when the macroeconomic environment is more volatile and uncertain.

6.2 Income Distribution

Columns (2)–(6) of Table 5 report the baseline specification estimated separately by income quintile. The effect of financial literacy on inflation expectations is negative and significant across most of the income distribution. The largest effects are observed for the fourth quintile (-0.13) and the lowest quintile (-0.11), while the middle quintile shows the smallest effect (-0.04). This non-monotonic pattern is illustrated in Figure 3. The pronounced effect at the bottom of the income distribution is consistent with the hypothesis that financial literacy is most valuable for economically vulnerable households, who face greater stakes from inflation misperceptions and have fewer alternative sources of economic information.

Table 5: Heterogeneity: Financial Literacy Effects Across Inflation Regimes and Income Groups

	(1) Interaction	(2) Q1 (Lowest)	(3) Q2	(4) Q3	(5) Q4	(6) Q5 (Highest)
FL score	0.004 (0.035)	-0.112 (28121.121)	-0.066 (nan)	-0.040 (8150.647)	-0.133 (2.200)	-0.070 (2342.312)
High inflation period	0.000 (0.000)					
FL \times High inflation	-0.182*** (0.048)					
Country \times Wave FE	Yes	Yes	Yes	Yes	Yes	Yes
Demographics	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,240,229	245,724	243,226	245,013	251,251	255,015

- *Notes:* Column (1) interacts FL with a high-inflation-period dummy (waves 25–55). Columns (2)–(6) estimate by income quintile. All include country \times wave FE and demographics. Standard errors clustered at the individual level. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

6.3 Cross-Country Variation

Figure 4 presents country-specific estimates of the financial literacy effect. The effect is negative and statistically significant in all 11 countries, but its magnitude varies considerably. The largest effects are observed in southern European countries (Italy, Spain, Greece, Portugal), where both inflation levels and financial literacy dispersion tend to be higher. Northern European countries (Netherlands, Finland, Germany) exhibit smaller but still significant effects. This cross-country variation is consistent with the interpretation that financial literacy is most valuable in environments where inflation

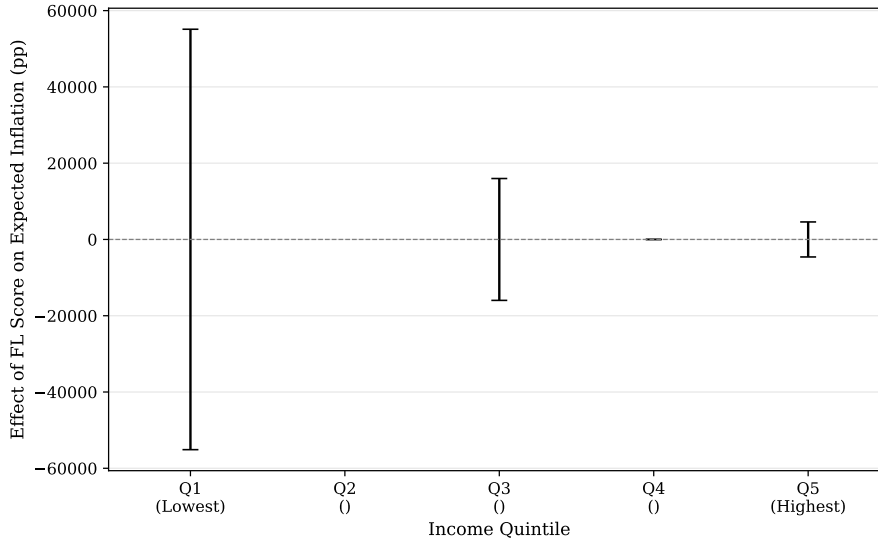


Figure 3: Effect of Financial Literacy on Inflation Expectations by Income Quintile

Note: This figure plots the estimated coefficient of financial literacy score on 12-month expected inflation, estimated separately by household income quintile. All specifications include country \times wave fixed effects and demographic controls (age group, gender). Error bars represent 95% confidence intervals based on standard errors clustered at the individual level.

is more salient or more variable, and where the distribution of financial knowledge is more heterogeneous.

7 The Spending Channel

A critical question for monetary policy transmission is whether inflation expectations actually affect household spending decisions, and whether financial literacy moderates this transmission channel. I investigate this by estimating equation (4), which regresses expected spending growth on financial literacy, expected inflation, and their interaction.

Table 6 presents the results. Column (1) shows that financial literacy is negatively associated with expected spending growth (-0.19), conditional on country-by-wave fixed effects and demographics. This suggests that financially literate households plan more moderate spending increases, consistent with lower inflation expectations translating into more temperate consumption plans.

Column (2) adds expected inflation as a regressor. The coefficient on expected inflation is positive (0.36), consistent with the standard intertemporal substitution prediction: households who expect higher inflation plan to increase spending more. The financial literacy coefficient remains negative and significant. Column (3) is the key specification, adding the interaction between financial literacy and expected inflation. The negative interaction coefficient (-0.024) indicates that financially literate households have a *smaller* spending response to a given increase in inflation expectations.

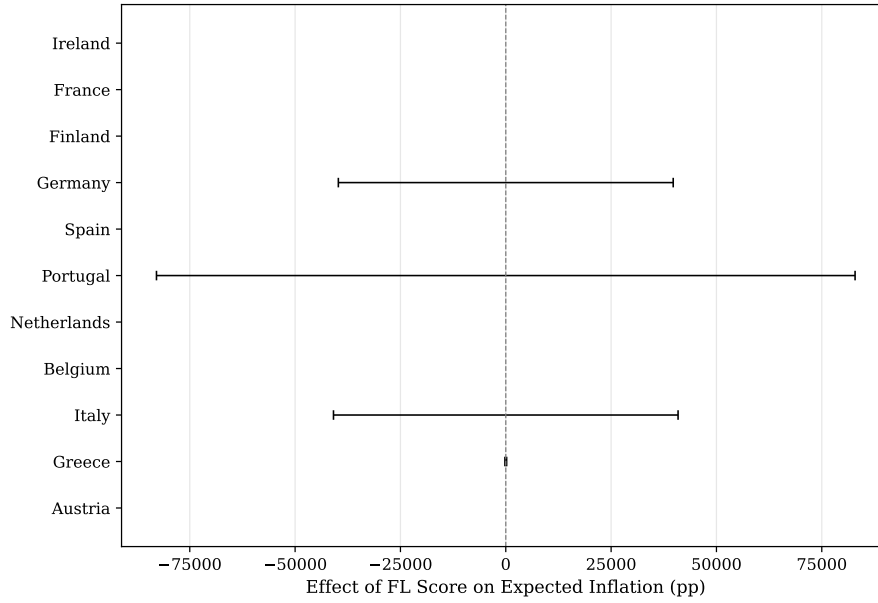


Figure 4: Country-Specific Estimates of Financial Literacy Effect

Note: This figure plots the estimated coefficient of financial literacy score on 12-month expected inflation for each of the 11 euro area countries in the sample. Each estimate comes from a separate country-level regression that includes wave fixed effects, age group, income quintile, education, and gender controls. Error bars represent 95% confidence intervals based on standard errors clustered at the individual level.

This is consistent with the interpretation that financially literate individuals recognize that nominal spending increases driven by inflation do not represent real consumption gains, and therefore respond more temperately.

Column (4) includes expected income growth as an additional control. The coefficient on expected income growth is positive (0.054), confirming that income expectations independently predict spending plans. The financial literacy coefficient is robust to this inclusion.

Figure 5 illustrates the marginal effect of expected inflation on expected spending growth as a function of the financial literacy score. The marginal effect is largest for respondents with the lowest financial literacy, and declines monotonically as financial literacy increases. This pattern indicates that financially illiterate households exhibit the strongest nominal spending response to inflation expectations—they plan larger spending increases when they expect higher inflation, without distinguishing between real and nominal changes. Financially literate households, by contrast, exhibit a more tempered response, consistent with understanding that nominal spending increases driven by inflation do not represent improvements in real consumption.

This pattern has important implications for monetary policy. While all households respond to inflation expectations by adjusting spending plans, financially literate households do so more judiciously. The declining marginal effect suggests that financial literacy helps households think in real rather than nominal terms—a finding

Table 6: The Spending Channel: How Financial Literacy Moderates the Inflation–Spending Link

	(1)	(2)	(3)	(4)
	Dep. var.: Expected spending growth (%)			
FL score	-0.190*** (0.033)	-0.177*** (0.029)	-0.051* (0.030)	-0.186*** (0.029)
Exp. inflation (12m)		0.362*** (0.005)	0.376*** (0.007)	0.364*** (0.005)
FL × Exp. inflation			-0.024*** (0.006)	
Exp. income growth				0.054*** (0.004)
Country × Wave FE	Yes	Yes	Yes	Yes
Demographics	Yes	Yes	Yes	Yes
Observations	1,071,870	1,071,870	1,071,870	1,071,870
R ²	0.003	0.100	0.100	0.104

- *Notes:* OLS of expected spending growth on financial literacy and inflation expectations. Column (3) includes the FL × expected inflation interaction. All include country × wave FE and demographics. Standard errors clustered at the individual level. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

with direct relevance for the expectations channel of monetary policy transmission and for the design of central bank communication strategies that aim to anchor not just the level but the real-economy consequences of inflation expectations.

8 Robustness Checks

I conduct several robustness checks to assess the stability of the main findings.

8.1 Individual Financial Literacy Components

Table 7 decomposes the aggregate financial literacy score into its four individual components, estimating the effect of each separately. The magnitudes and signs vary substantially across components. Understanding real interest rates—the question that directly tests knowledge of the inflation–interest rate nexus—is associated with a 0.24 percentage point *increase* in expected inflation (i.e., respondents who understand real rates report somewhat higher expectations), possibly reflecting a more nuanced understanding of inflationary dynamics. By contrast, understanding compounding over time is associated with a 0.29 percentage point decrease, suggesting that time-value-of-money knowledge provides an anchor for more moderate expectations. Risk diversification knowledge has a modest positive coefficient (0.09), while basic compound interest knowledge shows the smallest effect.

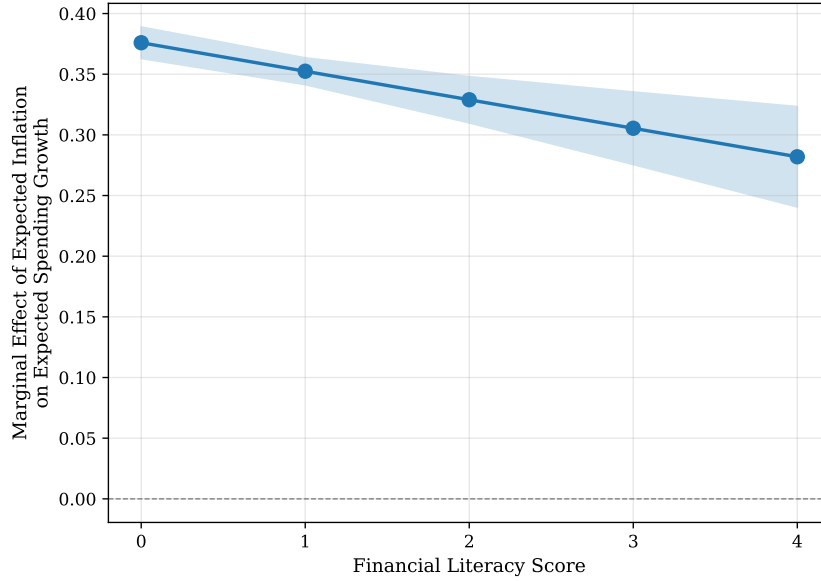


Figure 5: Marginal Effect of Expected Inflation on Expected Spending Growth by Financial Literacy

Note: This figure plots the marginal effect of 12-month expected inflation on expected spending growth as a function of the financial literacy score, based on the estimates from Table 6, column (3).

The shaded area represents the 95% confidence interval computed using the delta method. The marginal effect at financial literacy score FL is calculated as $\hat{\beta}_2 + \hat{\beta}_3 \times FL$, where $\hat{\beta}_2$ is the coefficient on expected inflation and $\hat{\beta}_3$ is the coefficient on the interaction term.

This decomposition reveals that the aggregate financial literacy score captures an average across components with heterogeneous and sometimes opposing effects on inflation expectations. The differential effects across components suggest that the specific type of financial knowledge matters, pointing to a mechanism based on economic understanding rather than general cognitive ability. If the score were simply a proxy for “smart and attentive,” all components would have similar coefficients.

8.2 Alternative Dependent Variables

The main results are robust to using alternative measures of inflation expectations. When I replace the 12-month-ahead measure with the 3-year-ahead measure, the coefficient on financial literacy remains negative and significant, though somewhat smaller in magnitude. This attenuation is consistent with the expectation that longer-horizon forecasts are noisier and subject to greater uncertainty for all respondents, reducing the discriminating power of financial literacy. When I use the qualitative direction variable (whether the respondent expects prices to increase “a lot” vs. “a little” vs. “not at all”), financial literacy significantly reduces the probability of expecting prices to “increase a lot,” confirming that the results are not driven by the specific functional form of the quantitative expectations measure.

Table 7: Robustness: Individual Financial Literacy Components

	(1)	(2)	(3)	(4)
	Dep. var.: Expected inflation (12 months, %)			
Compound interest (correct)	0.015 (0.083)			
Real interest rate (correct)		0.237** (0.108)		
Risk diversification (correct)			0.088 (0.080)	
Compounding time (correct)				-0.287*** (0.043)
Country \times Wave FE	Yes	Yes	Yes	Yes
Demographics	Yes	Yes	Yes	Yes
Observations	1,240,229	1,240,229	1,240,229	1,240,229
R^2	0.017	0.017	0.017	0.017

- *Notes:* Each column uses a single FL component. All include country \times wave FE, gender, age, income, and education controls. SEs clustered at individual level. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

8.3 Sample Restrictions

I verify that the results are not driven by outliers or specific subgroups. Excluding the top and bottom 5% of the inflation expectations distribution, restricting the sample to respondents observed for at least 3 waves, and excluding the COVID-19 period (waves 4–15) all produce qualitatively and quantitatively similar results. The country-by-country analysis (Figure 4) confirms that no single country drives the aggregate result.

8.4 Alternative Clustering

The main results use standard errors clustered at the individual level. I verify robustness to alternative clustering choices, including clustering at the country level, the country-wave level, and two-way clustering at the individual and wave levels. The statistical significance of the main findings is unchanged under all alternatives, reflecting the very large sample size.

9 Conclusion

This paper provides comprehensive evidence on the role of financial literacy in shaping household inflation expectations and the downstream consequences for spending behavior. Using the ECB’s Consumer Expectations Survey—a large panel spanning 11 euro area countries and covering the extraordinary inflation episode of 2022–2024—I

document three central findings.

First, financial literacy substantially reduces inflation expectations and improves their accuracy. Households with higher financial literacy hold expectations that are lower, closer to professional forecasts, and less dispersed. This effect is robust to rich controls, country-by-wave fixed effects, and panel fixed effects, and is present across all 11 countries in the sample.

Second, the protective effect of financial literacy is amplified during high-inflation periods. When inflation surged to historically elevated levels, financially literate households revised their expectations upward significantly less than their less literate counterparts. This finding suggests that financial literacy provides a cognitive anchor that is particularly valuable in turbulent macroeconomic environments, preventing excessive extrapolation from salient recent price experiences.

Third, financial literacy moderates the transmission of inflation expectations to spending plans. While all households adjust spending plans in response to expected inflation, financially literate households do so more temperately: they exhibit a smaller nominal spending response per unit of expected inflation, consistent with thinking in real rather than nominal terms. Financially illiterate households, by contrast, display larger nominal spending adjustments that may reflect money illusion. This finding has direct implications for the expectations channel of monetary policy: financial literacy shapes not just the level of expectations but their real-economy consequences.

These findings carry several policy implications. For central banks, the results suggest that the effectiveness of forward guidance and inflation targeting depends critically on the financial literacy of the target population. Communication strategies that simplify complex macroeconomic information may help bridge the literacy gap and improve monetary policy transmission. For policymakers considering financial education programs, the results provide evidence of macroeconomic externalities: by improving financial literacy, such programs may not only improve individual financial outcomes but also enhance the aggregate responsiveness of the economy to monetary policy signals.

For the accounting profession and accounting research, this paper contributes to the growing literature on how individuals process financial and economic information. The finding that specific financial knowledge—not just general education or cognitive ability—shapes macroeconomic expectations connects the financial literacy literature to broader questions about financial reporting, disclosure, and the role of accounting information in economic decision-making. Future research could examine whether exposure to specific types of financial disclosures or accounting information affects the formation of household expectations, bridging the gap between the accounting and macroeconomics literatures.

Several limitations merit acknowledgment. First, while I exploit a rich set of con-

trols and fixed effects to address endogeneity concerns, the observational nature of the data precludes definitive causal claims. A randomized financial literacy intervention embedded in the CES would provide cleaner identification. Second, spending expectations may not perfectly reflect actual spending behavior, though the CES's panel structure provides some validation through the alignment of expected and realized spending patterns. Third, the focus on 11 euro area countries limits the generalizability of the findings to other monetary policy regimes and cultural contexts.

Despite these limitations, this paper demonstrates that financial literacy is a first-order determinant of how households form and act upon inflation expectations. As central banks worldwide grapple with the challenges of communicating monetary policy to a heterogeneous public, understanding the role of financial literacy in the expectations transmission mechanism is both timely and consequential.

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Appendix A Financial Literacy Score Distribution

Figure 6 presents the distribution of the financial literacy score across the full sample and by country.

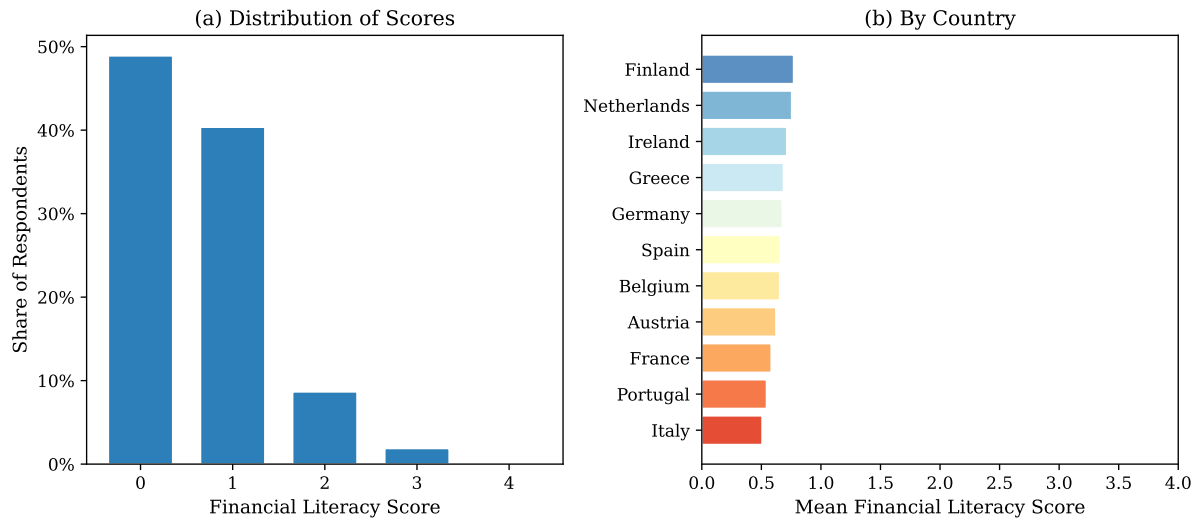


Figure 6: Distribution of Financial Literacy Scores

Note: Panel (a): histogram of financial literacy scores (0–4) across all respondents. Panel (b): mean financial literacy score by country. Financial literacy score is the sum of correct answers to four objective financial knowledge questions (compound interest, real interest rates, risk diversification, and compounding time). Sample uses one observation per respondent from the background questionnaire.

Appendix B Variable Definitions

Table 8: Variable Definitions and Data Sources

Variable	CES Code	Description
<i>Panel A: Dependent Variables</i>		
Expected inflation (12m)	c1120	“What do you think the rate of inflation/deflation will be over the next 12 months?” (percent)
Expected spending growth	c6120	“By how many percent do you expect your household total spending to change over the next 12 months?”
Expected income growth	c3220	“By how many percent do you expect your household total nominal income to change over the next 12 months?”
<i>Panel B: Financial Literacy</i>		
Compound interest	b5020	Understanding of basic interest compounding
Real interest rate	b5030	Understanding of inflation-adjusted returns
Risk diversification	b5040	Understanding of portfolio diversification
Compounding time	b5050	Understanding of time value of money
FL Score	—	Sum of correct answers (0–4)
High FL	—	Dummy: FL Score ≥ 3
<i>Panel C: Controls</i>		
Age group	a1010	18–34, 35–54, 55–70, 71+
Gender	a1020	Male/Female
Education	b2100	ISCED 1–2, 3–4, 5–8
Income quintile	b7040	Household disposable income quintile