

Money illusion and money delusion: the impact of perceived inflation on subjective well-being

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Abstract

Does money buy happiness? To answer this question, the role of nominal income has been extensively studied, while the price level has received scant attention in microeconomic applications. In this paper we focus on individually perceived inflation and relax the assumptions that 1) losses and gains affect well-being symmetrically; 2) heterogeneous consumers face homogeneous inflation and 3) official inflation is what matters to consumers. We exploit newly available longitudinal data on life satisfaction in France and the opinion price index to estimate the effect of perceived price variations on satisfaction. Perceived inflation is confirmed to strongly predict well-being, even when controlling for relevant socio-demographic factors. We estimate its impact to be higher than an equivalent change in perceived nominal income, challenging the hypothesis of money illusion, but in line with the hypothesis of delusive recall biases. These results suggest that monetary policies should focus on the various determinants of perceived inflation, not only to handle inflation expectations but also to raise citizens' welfare.

Keywords:

perceived inflation, opinion price index, life satisfaction, subjective well-being, recall bias

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