

Heterogeneity in Inflation and Substitution Across Households

Rahel Braun,* and Sarah M. Lein†

11 March, 2019

Preliminary and incomplete. Please do not cite or circulate.

Abstract

Aggregate inflation rates do not need to be representative for individual consumers. Furthermore, consumers are likely to experience preference shocks. Two features which are neglected in standard inflation calculations, and which we address in this paper using homescan data for Switzerland.

More specifically, we estimate inflation rates at the household level, not only with the conventionally used statistical approach, but also with an economic approach (based on the theory of consumer behavior). The latter approach includes estimations of the price elasticity of substitution and allows for preference shocks for individual goods. We find that inflation rates are dispersed with an interquartile range of 3.9 (6.3) for the statistical (economic) approach. However, we can not find a relationship with socioeconomic variables. On the other hand we find that rich households have a higher elasticity of substitution indicating that preferences are non-homothetic.

*Department of Business and Economics, University of Basel. Email: rahel.braun@unibas.ch

†Department of Business and Economics, University of Basel, and KOF ETH Zurich. Email: sarah.lein@unibas.ch