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## **Assignment VII**

### **Question I**

#### **Rational Expectations and Measures of Expected Inflation**

How would the hypothesis of rational expectations help us to measure inflationary expectations? What seem to be the pluses and minuses of this approach?

Solution

Rational expectations applied to inflation expectations imply that the estimates should be the best possible (very difficult to show that any estimate is the best one). The difficulty comes in specifying what information people had available, and how they combined this information to get the best estimate.

### **Question II**

#### **The Livingston Survey**

Consider the Livingston survey of inflationary expectations. What are the pluses and minuses of using this type of information to measure expected rates of inflation?

Pluses

- Readily available.
- No need for additional assumptions to compute it.

Minuses

- Sample used may not be representative of actual participants
- Not clear how seriously participants take their reply.