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Disagreement about inflation and the yield curve

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Abstract

We show that inflation disagreement, not just expected inflation, has an impact on nominal interest rates. In contrast to expected inflation, which mainly affects the wedge between real and nominal yields, inflation disagreement affects nominal yields predominantly through its impact on the real side of the economy. We show theoretically and empirically that inflation disagreement raises real and nominal yields and their volatilities. Inflation disagreement is positively related to consumers' cross-sectional consumption growth volatility and trading in fixed income securities. Calibrating our model to disagreement, inflation, and yields reproduces the economically significant impact of inflation disagreement on yield curves.

\textit{JEL classification:} D51, E43, E52, G12.

\textit{Keywords:} Inflation disagreement, Real and nominal yields, Yield volatilities, Cross-sectional consumption growth volatility, Speculative trade

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