

Firm expectations and economic activity*

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Abstract

To what extent do firms' expectations impact current decision making? In this paper, we take up the issue by relying on a particular data set and a novel identification strategy. Specifically, our analysis is based on the EBDC Business Expectations Panel. To identify the causal effect of firm expectations on their behavior, we match firms on the basis of fundamentals and compare price-setting and production decisions of firms that have the same fundamentals but differ in their views about the future. We find that optimistic firms are about 15 percent more likely to raise production relative to neutral firms in the impact period. This effect remains strong and highly significant in the following months. Similarly, we also find that optimistic firms are considerably more likely to raise prices. In the second step of our analysis we match, in turn, correctly and incorrectly optimistic to neutral firms and study the difference in their behavior over time. It turns out that incorrect optimists and pessimists do not behave differently from untreated firms, except for the impact period. This testifies to the presence of animal spirits. In a third step, we quantify the contribution of news and noise to aggregate fluctuations.

Keywords: Expectations, Firms, Survey data, Propensity score matching,
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