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Finance and Economics Discussion Series: Stock Prices, Expected Returns, and Inflation

By Steven A Sharpe

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****. This paper examines the effect of expected inflation on stock prices and expected long-run returns. An ex ante estimates measure of expected long-run returns is derived by incorporating estimates of expected of future corporate cash flows into a variant of the Campbell-Shiller dividend-price ratio model. In this model, the log earnings-price ratio is expressed as a linear function of expected future returns, expected earnings growth rates, and the log of the current dividend-payout ratio. Expectations of earnings growth are inferred from equity analysts earnings forecasts, while inflation expectations are drawn from surveys of professional forecasters. I find that the negative relation between equity valuations and expected inflation results from two effects: higher expected inflation coincides with (i) lower expected real earnings growth and (ii) higher required real returns. The earnings channel is not merely a reflection of inflation's recession-signalling properties; rather, much of the negative valuation effect results from a negative relation between expected inflation and expected longer-term real earnings growth. The effect of expected inflation on required (long-run) real stock returns is also substantial. A one...



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