

LOSING THE INFLATION ANCHOR

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Discussion by
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RESPONSE TO THE COVID CRISIS: BACK TO THE 1970s?

Monetary policy

- Interest rates at record-low levels
- Massive Quantitative Easing (+ trillions on the Fed's balance sheet)
- Promise to keep interest rates low until 2023 (forward guidance)
- Assortment of lending facilities

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Too much? Larry Summers: "[new fiscal stimulus will] set off inflationary pressures of a kind we have not seen in a generation."

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 - Central bankers have a “credibility/inattention” capital
 - Explains compounding of mistakes (little knowledge/measurement of inflation expectations, bad theories, etc.)

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 - The right tail in the cross-sectional distribution
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- Leading indicator: increases in disagreement and mean forecasts may signal rising inflationary pressures

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 - Brazil, 2011-2016
 - Turkey, 2018-...
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Great paper full of insights!

INFLATION EXPECTATIONS: STATE OF KNOWLEDGE

- Alan Greenspan (1994): “I am not saying what [inflation expectations] is a function of. We know it’s a very difficult issue, but **that is the key variable**. It’s important, but just because **we can’t make a judgment** as to what these driving forces are in an econometric sense doesn’t mean that it’s not real.”

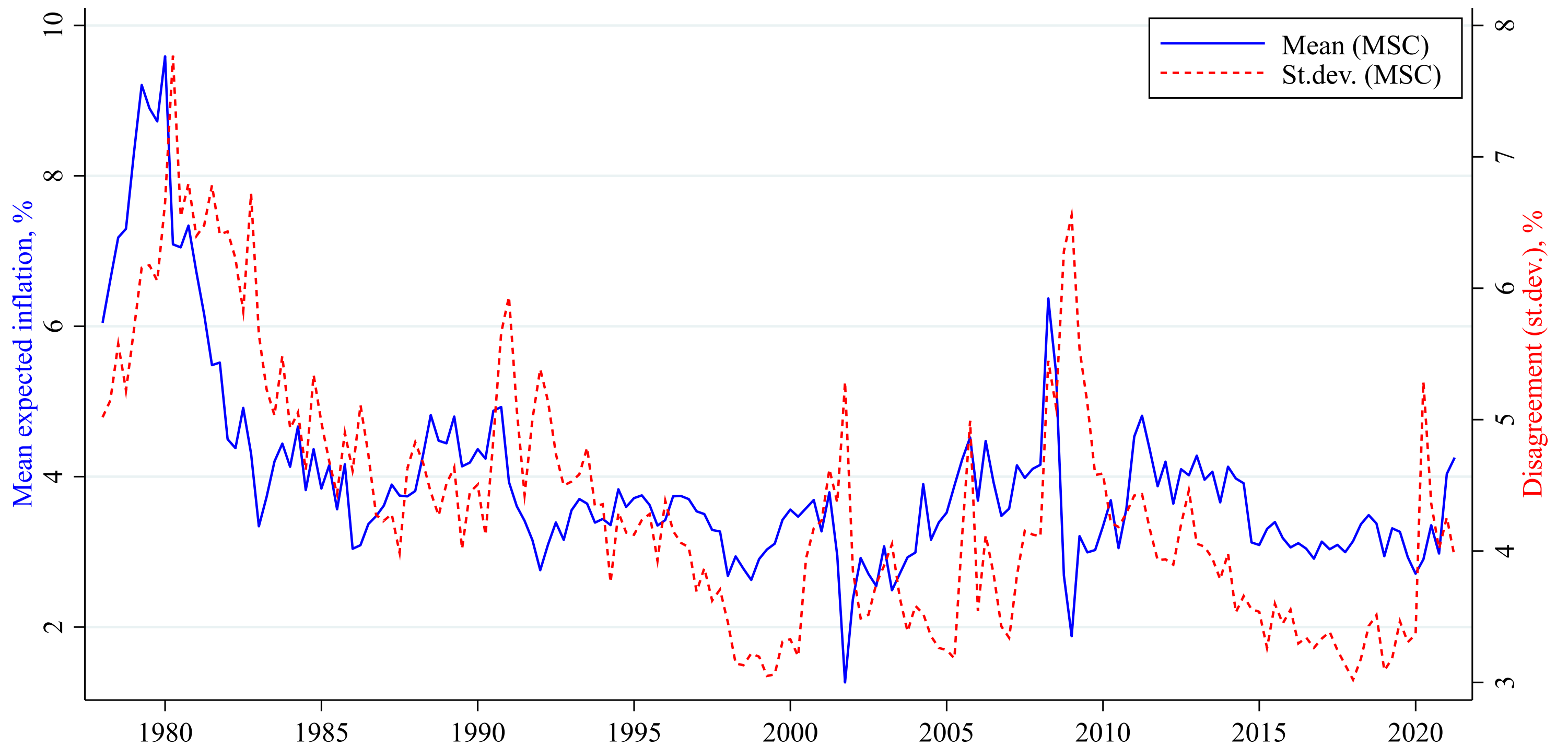
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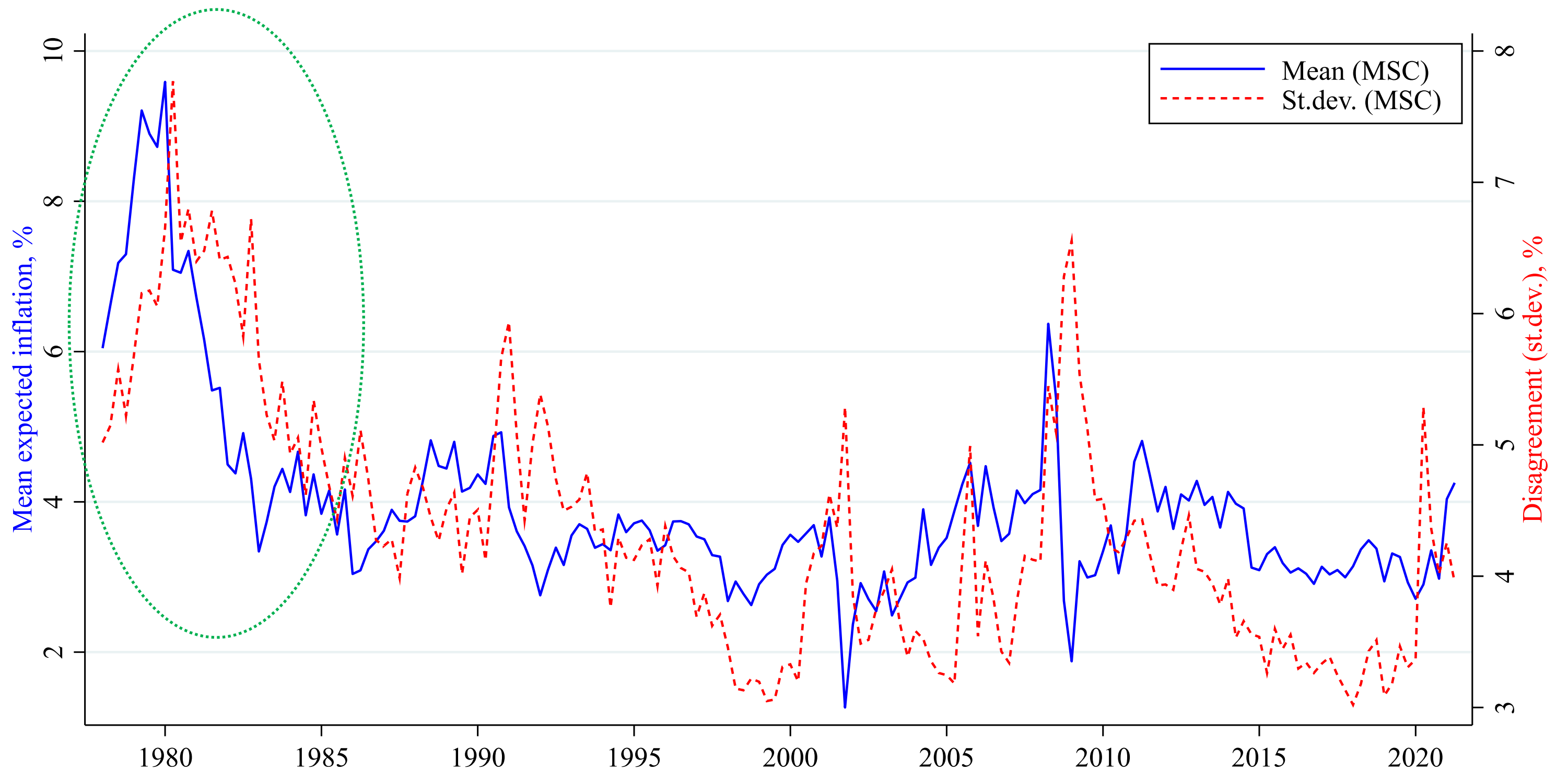
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- Janet Yellen (2016): “Perhaps **most importantly**, **we need to know more** about the manner in which inflation expectations are formed and how monetary policy influences them.”

INFLATION “SCARES”



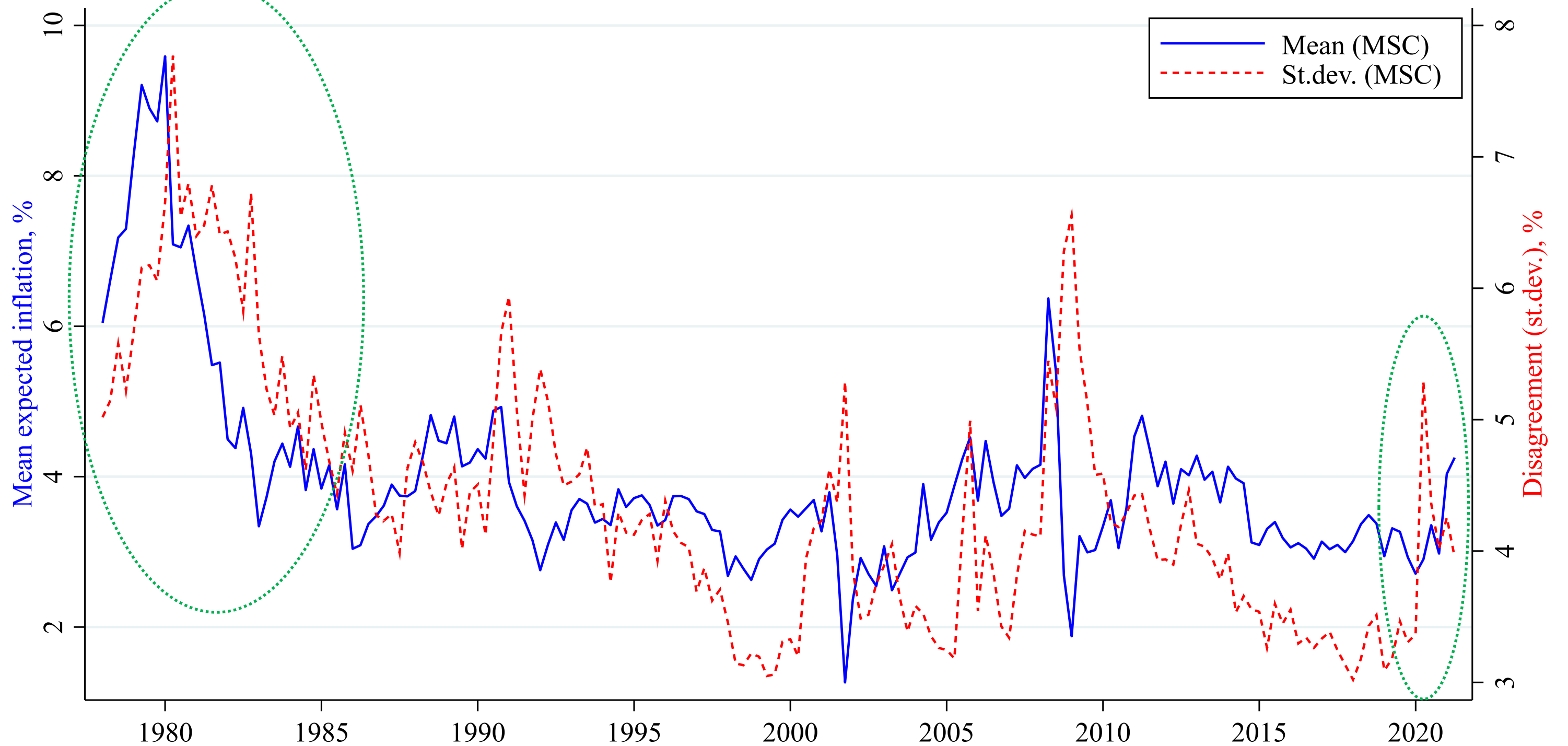
Source: Michigan Survey of Consumers

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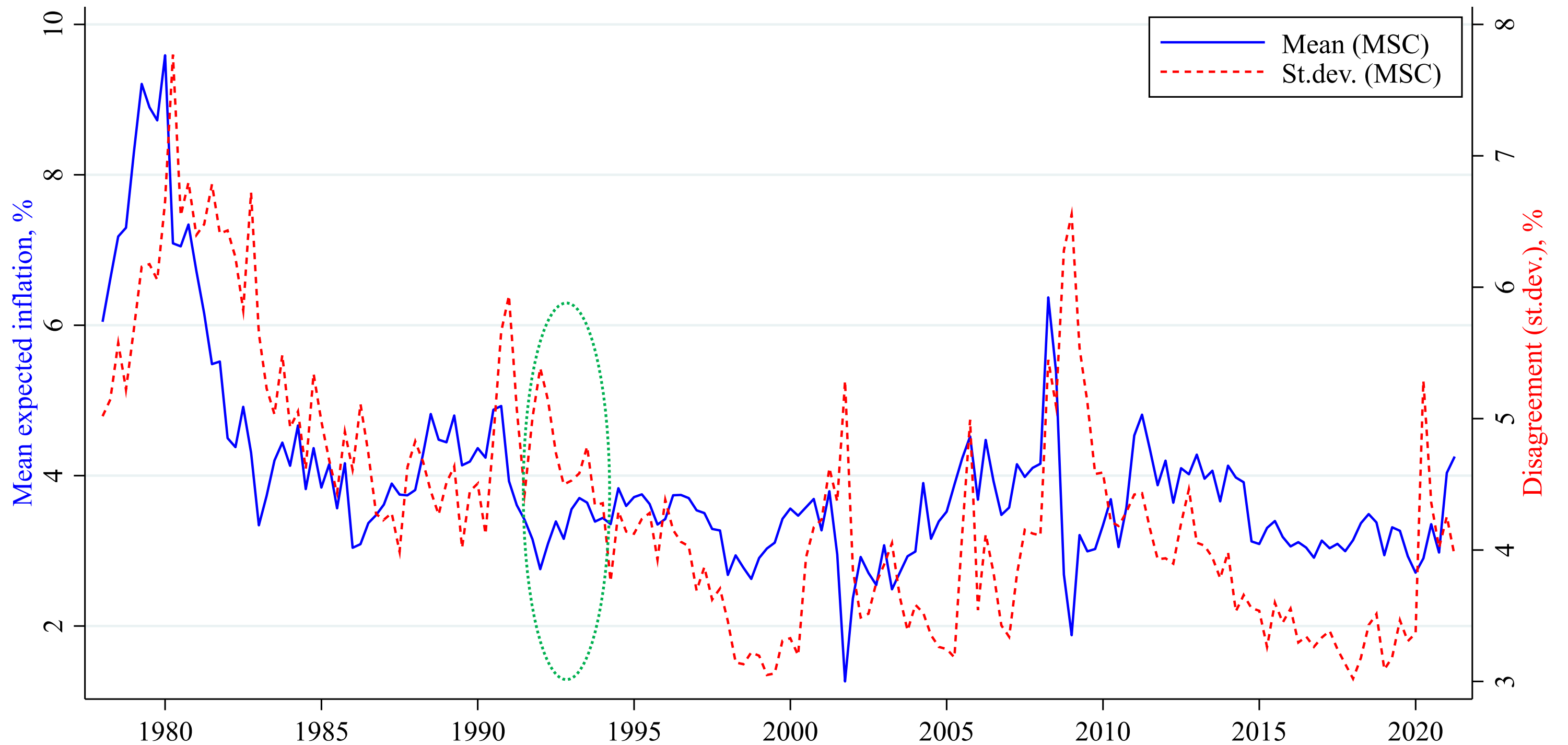
1970s: high expectations and disagreement

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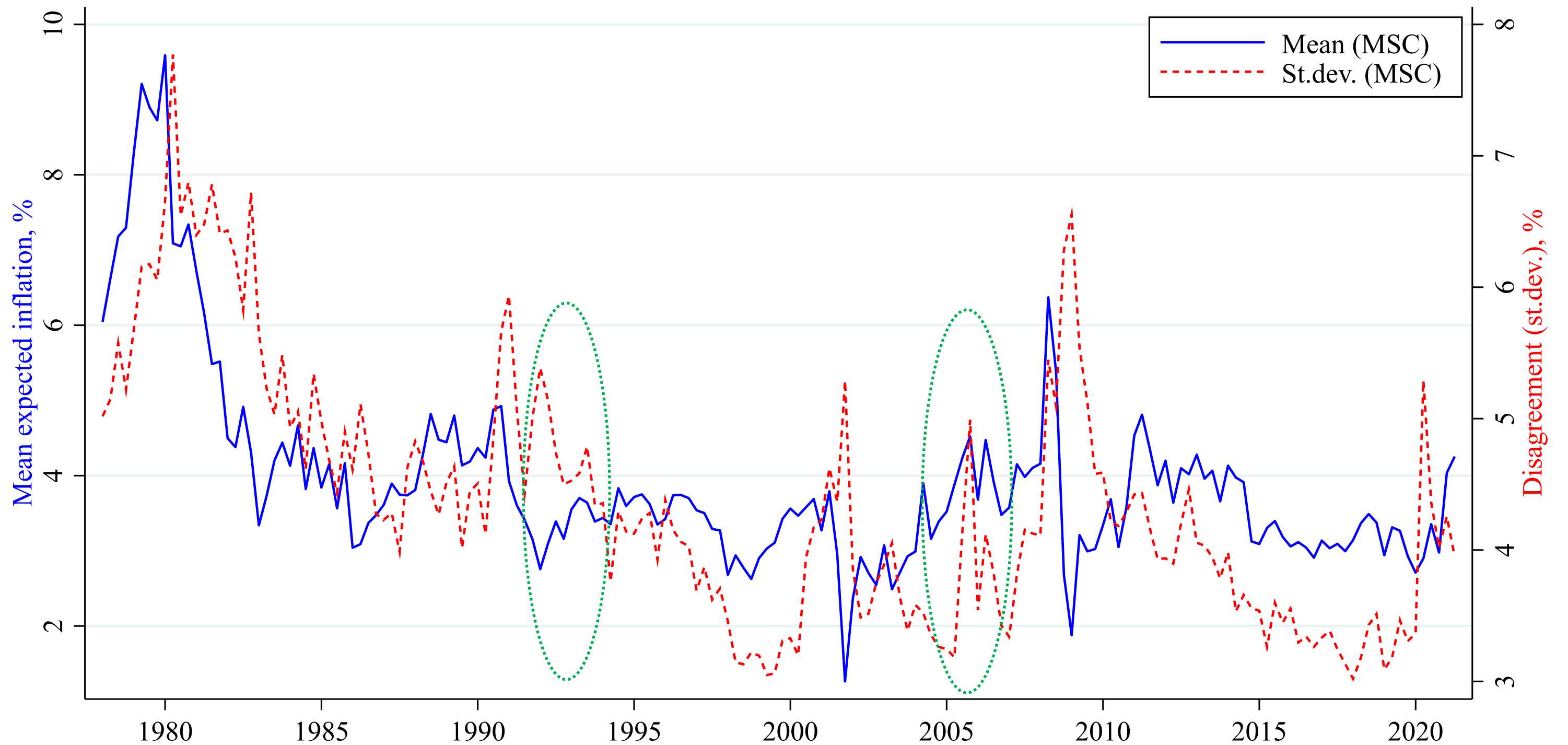
1970s: high expectations and disagreement ... and the same is starting to appear now (smaller scale?)

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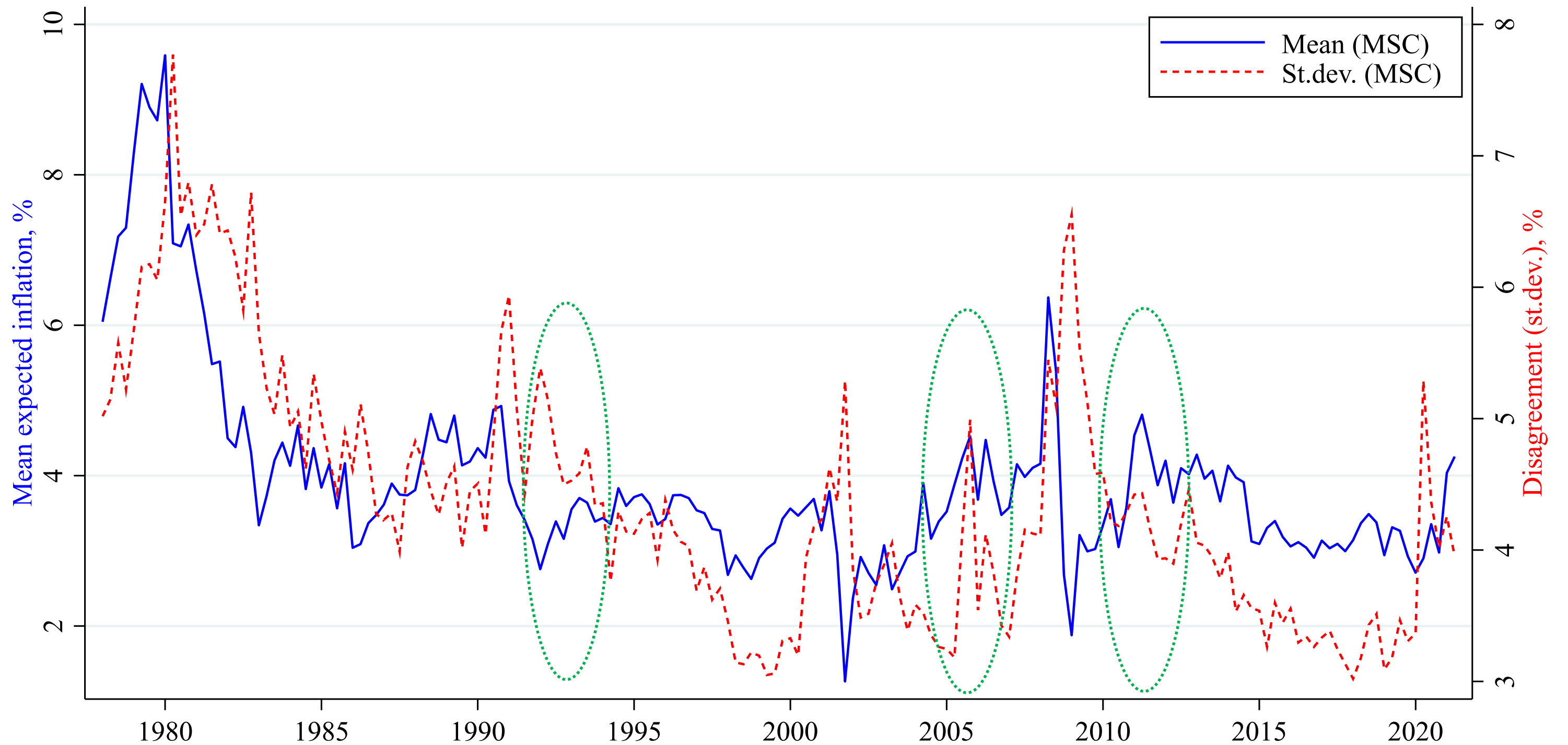
“False alarms”: inflation scare 1993-94

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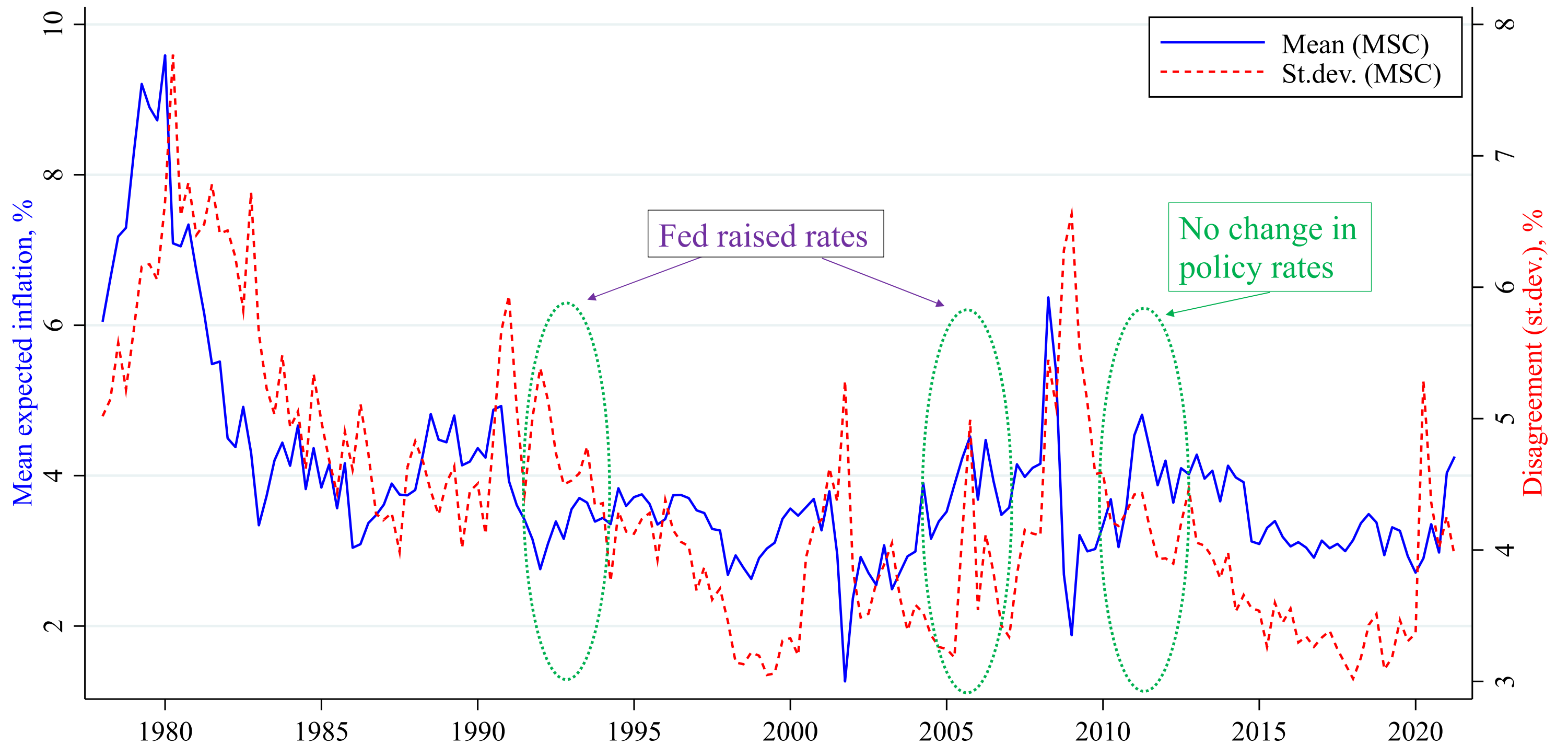
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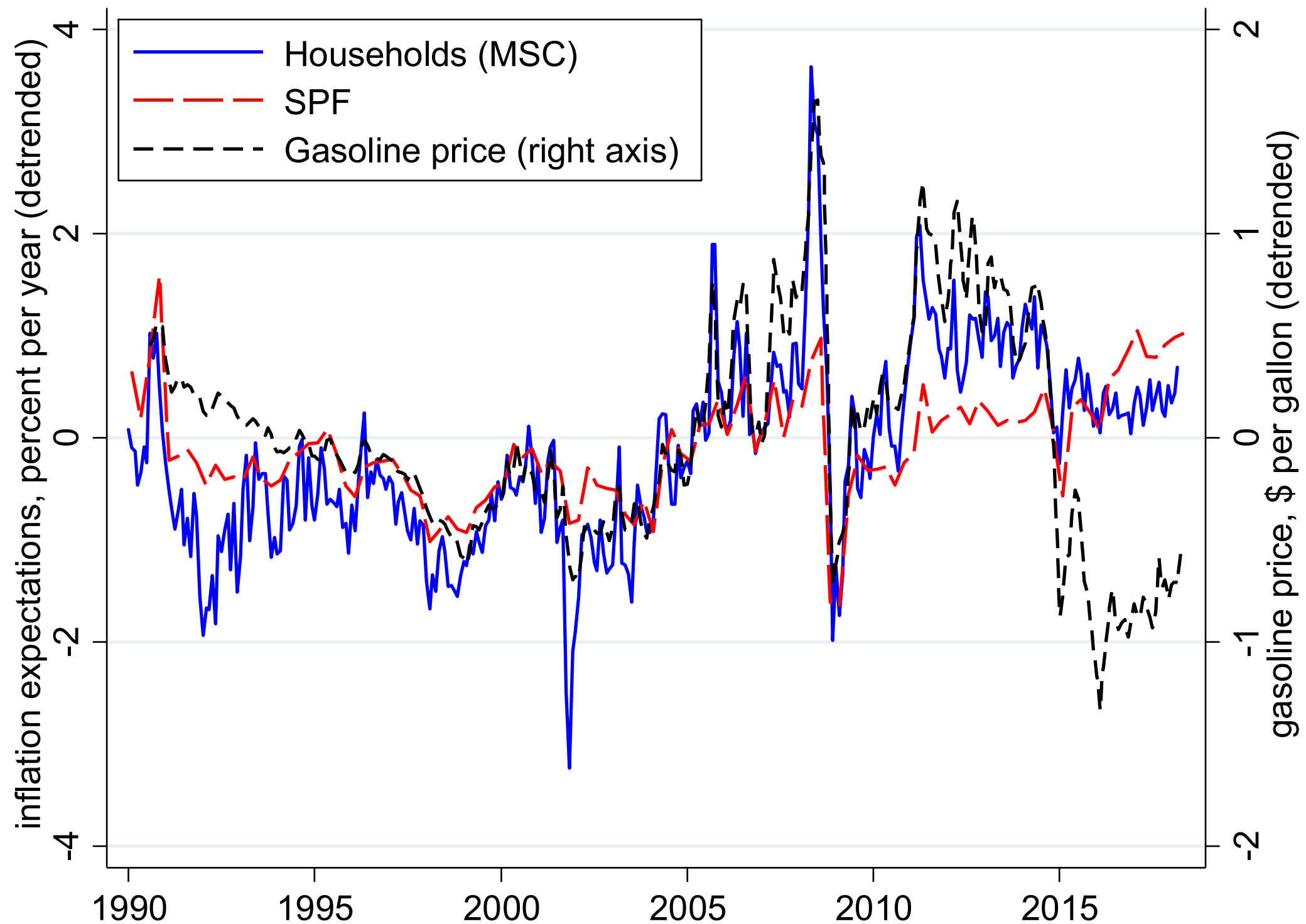
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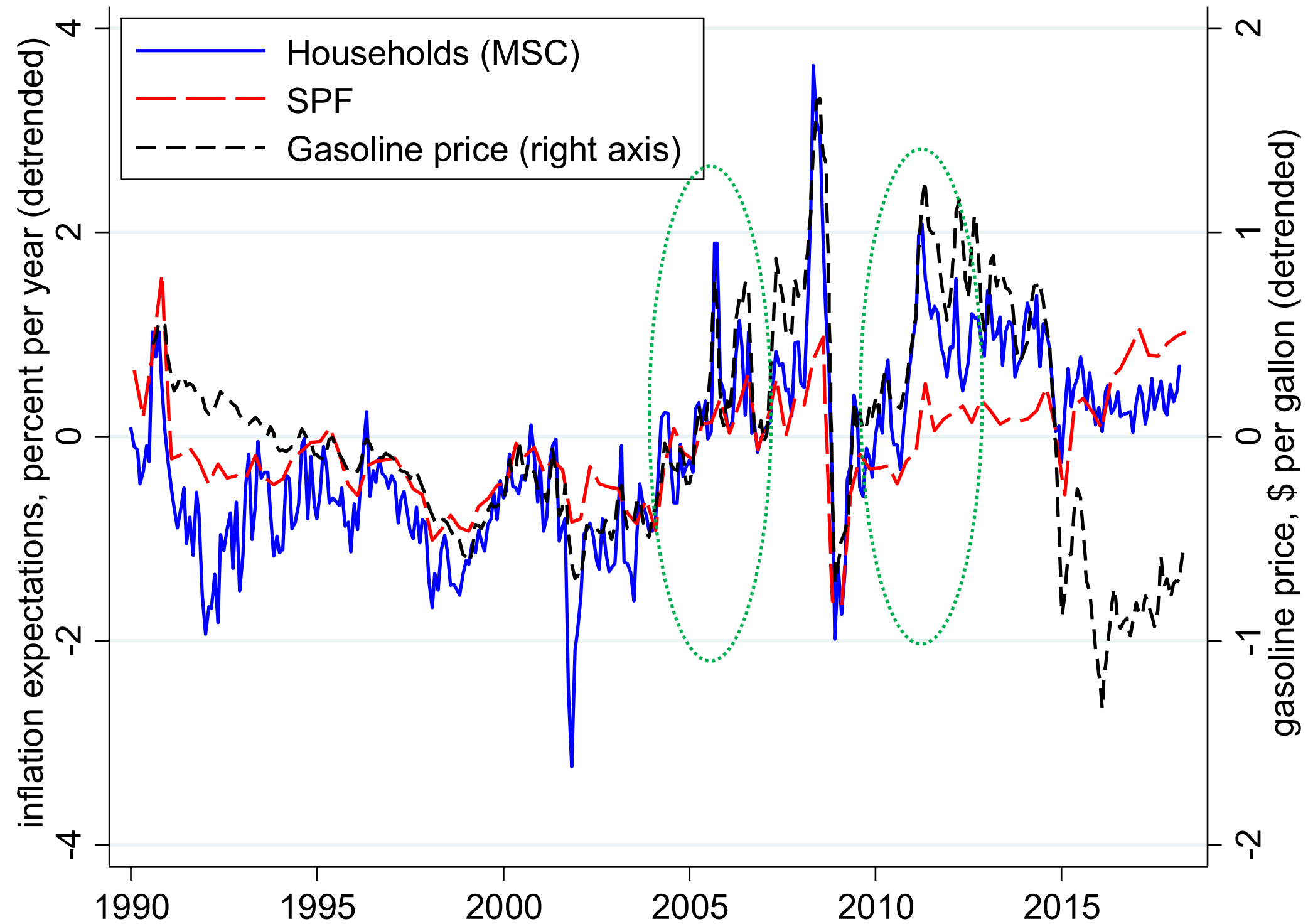
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WHAT DRIVES INFLATION EXPECTATIONS AND POLICY RESPONSE

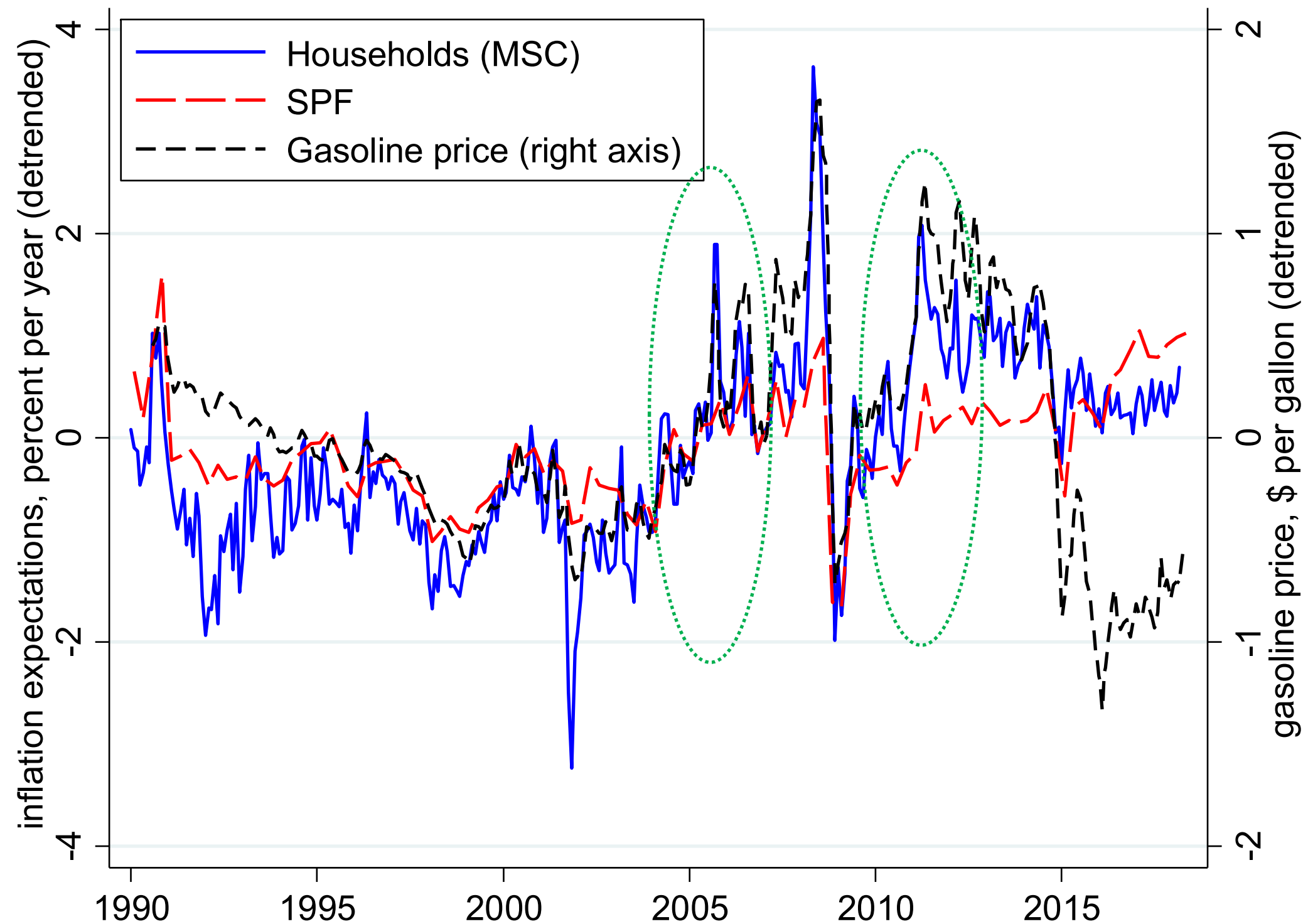


Households can confuse relative prices with inflation

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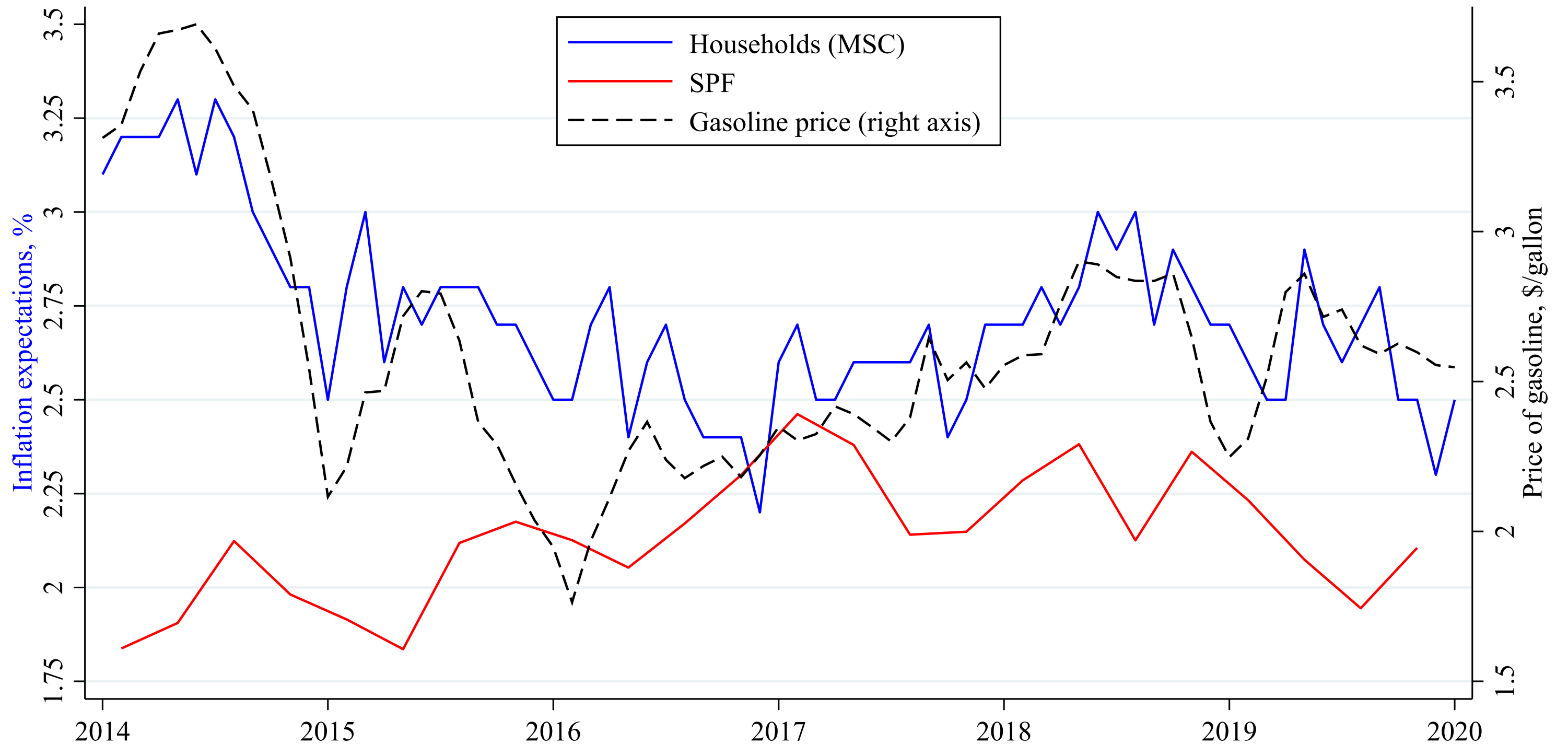


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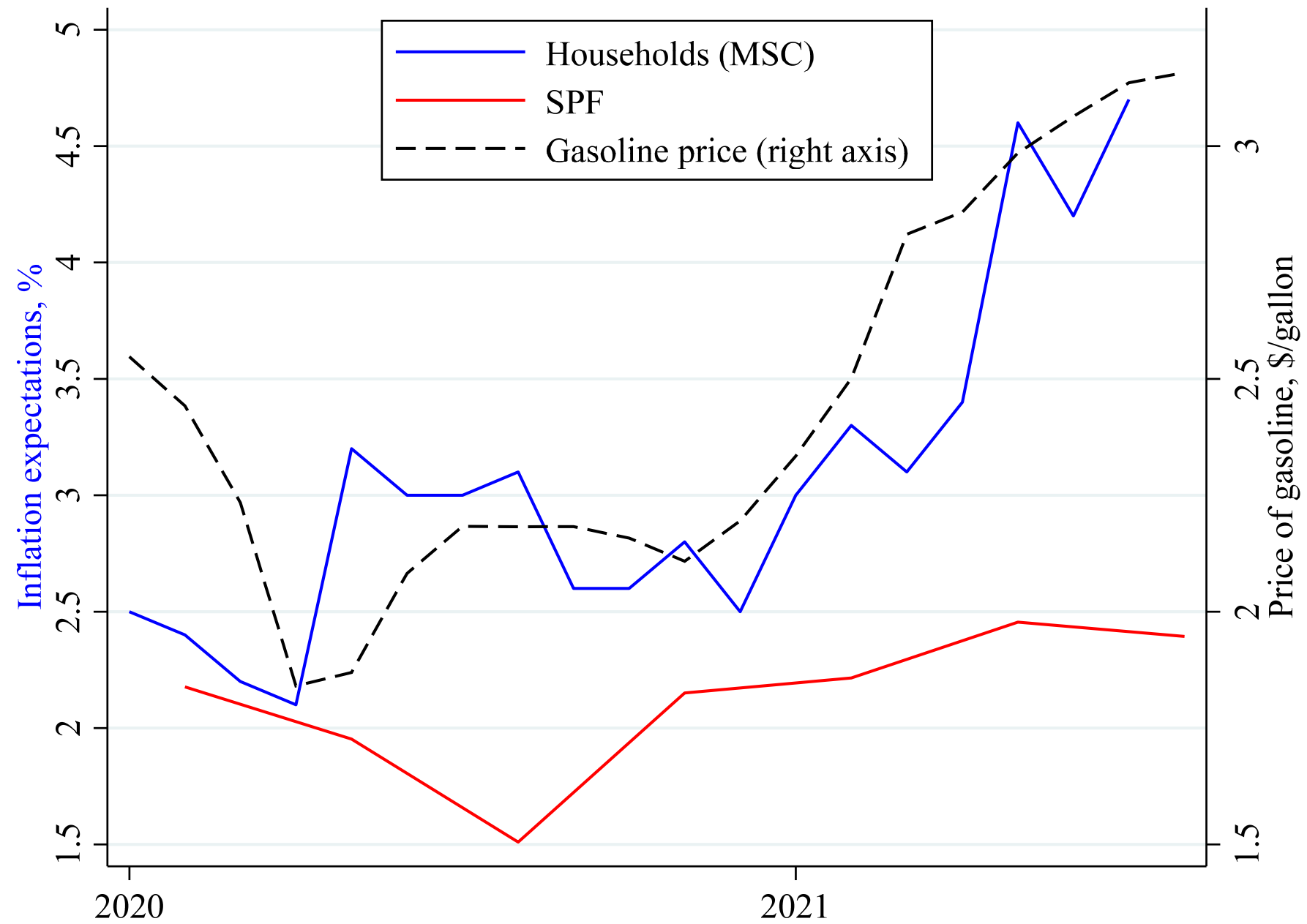
Transitory vs. persistent shocks to salient prices? Confuse relative price changes with inflation?

PRE COVID



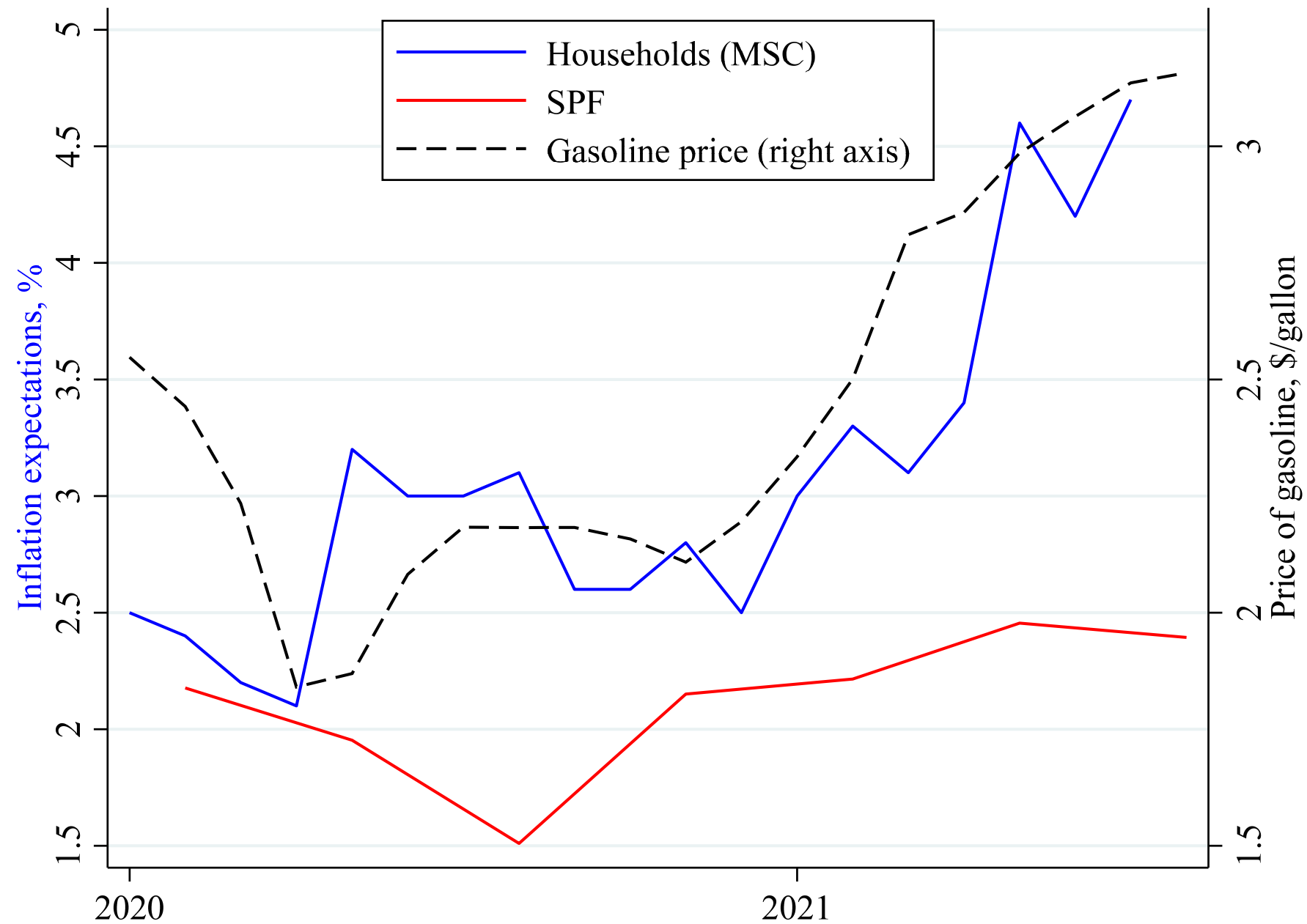
MSC tracks gas prices but SPF does not

COVID CRISIS



MSC tracks gas prices but SPF does not

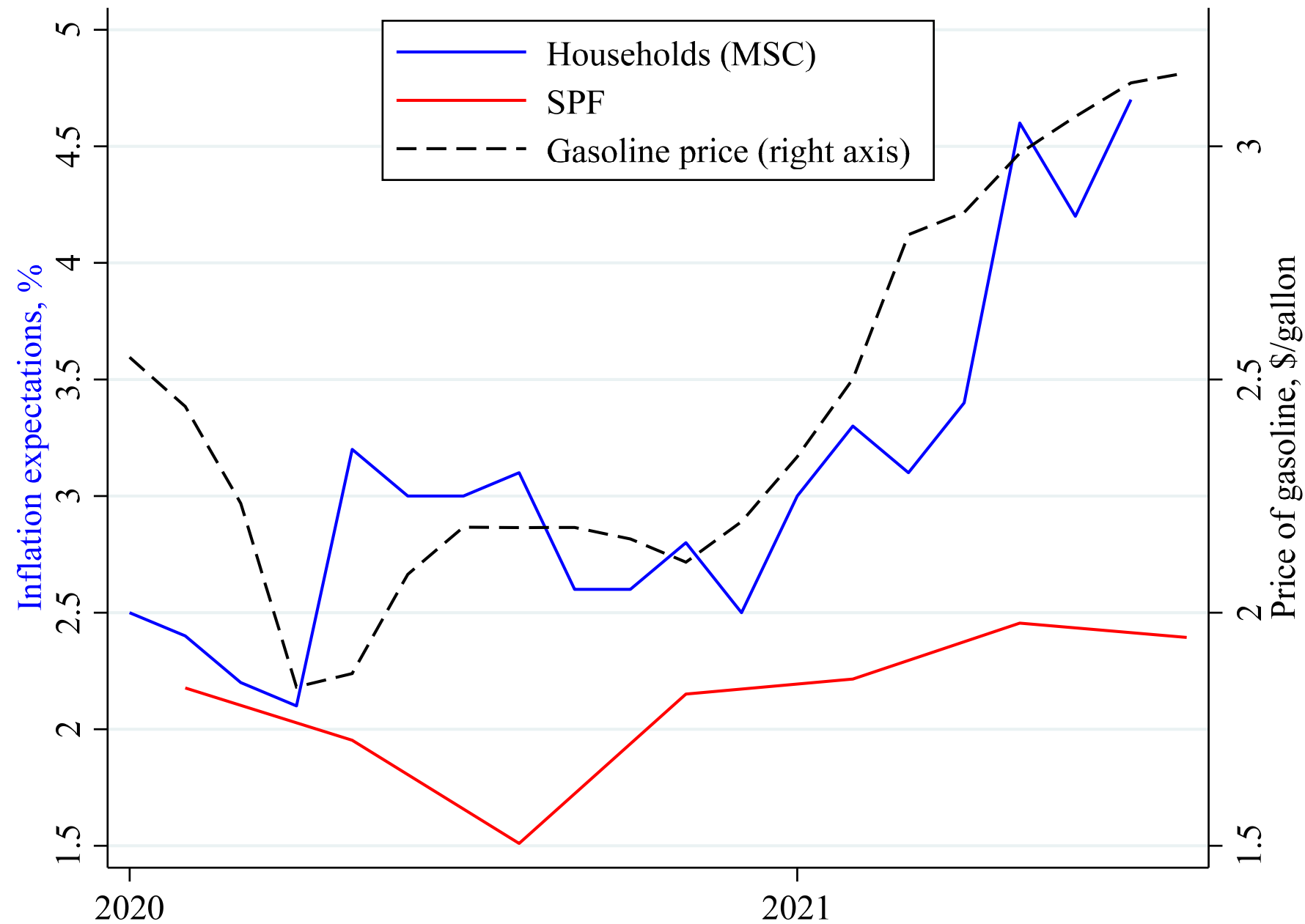
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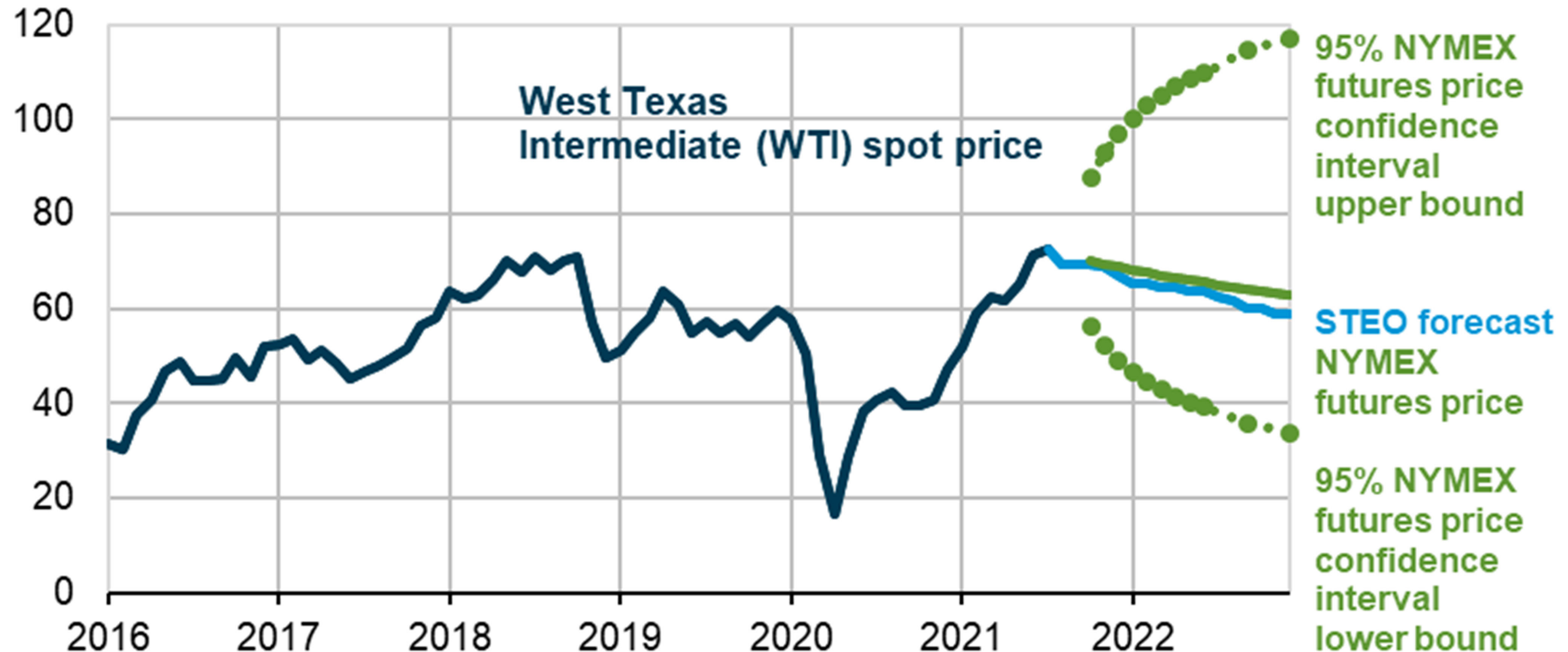


MSC tracks gas prices but SPF does not... repeat of 2011-2012?

EPOP is at 58.5% (roughly the level at the trough of the Great Recession)

OR IS SPF MAKING A MISTAKE?

West Texas Intermediate (WTI) crude oil price and NYMEX confidence intervals
dollars per barrel



Note: Confidence interval derived from options market information for the five trading days ending Aug 5, 2021. Intervals not calculated for months with sparse trading in near-the-money options contracts.

Sources: U.S. Energy Information Administration, Short-Term Energy Outlook, August 2021, CME Group, Bloomberg, L.P., and Refinitiv an LSEG Business



CONCLUDING REMARKS

- The Great Inflation of the 1970s spurred interest in measuring and understanding inflation expectations
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- The paper applies modern analysis to the 1970s and gives new insights
- Are we back to the 1970s? **Enormous uncertainty in the economic outlook...** but watch for the dynamics of salient prices (gasoline, milk, etc.).