Comments on
"Inflation Dynamics in Latin America:
Lessons from the COVID and Other Episodes"

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[‡] The findings, interpretations, and conclusions are those of the presenter and should not be attributed to the World Bank, its Executive Directors, or the countries they represent. Thanks to Guillermo Verduzco Bustos, Jongrim Ha, and Emiliano Luttini for discussions on the topic and useful inputs.

Summary: *What is the paper about?*

- ***Objective***. Analysis of inflation in Latin America (LAC) and comparison with advanced economies over the past two decades (low and stable inflation in LAC, significant commodity price volatility, global financial crisis, and COVID-19).

- ***Methodology.*** The New Keynesian Phillips curve (analysis of the determinants of inflation). Reduced form decomposition (analysis of inflation drivers). Monetary policy reaction functions (Taylor Rules).

- ***Database.*** Ha, Kose, and Ohnsorge (2023) *longer time series;* Bajraj, Carlomagno, and Wlasiuk (2023) *more granular information*.

- ***Ambitious draft with multiple empirical models, databases/samples, and results.***

Summary: *What are the main results?*

- ***Inflation convergence.*** Inflation *(level and volatility)* in LAC has recently converged to that in advanced economies.

- ***Inflation drivers.*** The surge in inflation in LAC during 2021-22 was mainly driven by the persistence of inflation (of core goods) and the rise in inflation expectations (of core services).

- ***Inflation response.*** The response of inflation in LAC to inflationary shocks in advanced economies is stronger and more persistent during periods of elevated (past) inflation and inflation expectations.

- ***Monetary policy.*** Monetary policy in LAC responds more (than advanced economies) to changes in inflation expectations and US interest rates

Four Comments

1 Convergence of LAC is temporary and likely driven by some other (policy) drivers.

2 Drivers of inflation are best explained by using models with well-defined shocks (supply/demand, global/external, commodity prices, interest rates)

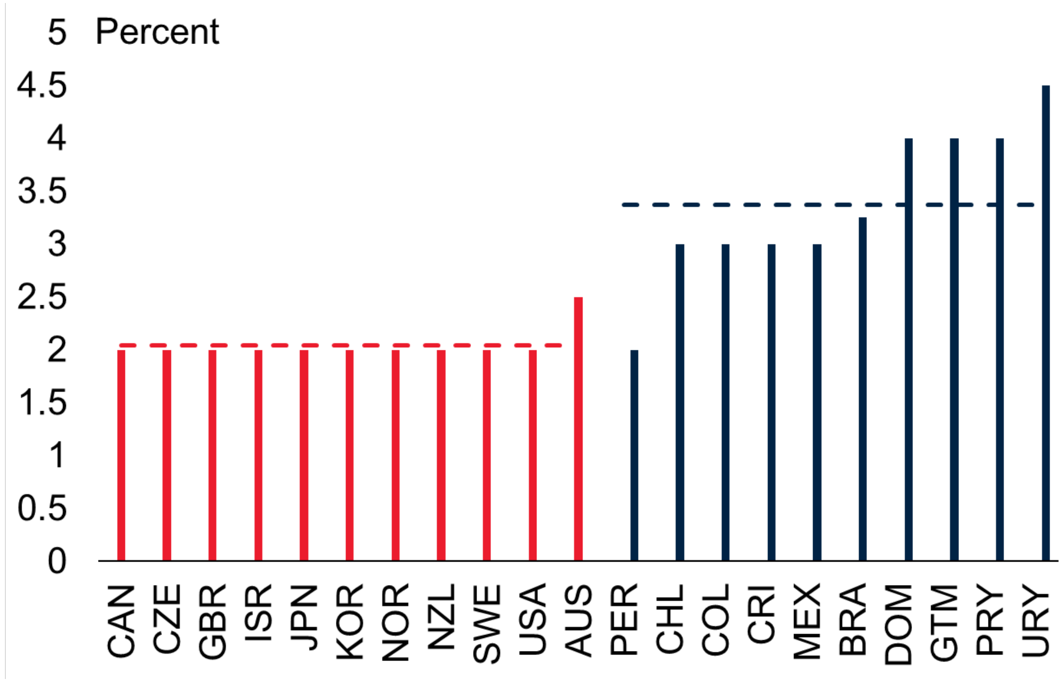
3 Currency depreciation plays a role in driving the surge in inflation and monetary policy responses

4 Better to focus on a smaller set of questions using fewer models with extensive robustness exercises

1. Convergence of Inflation
Temporary? Or New Normal? Drivers?

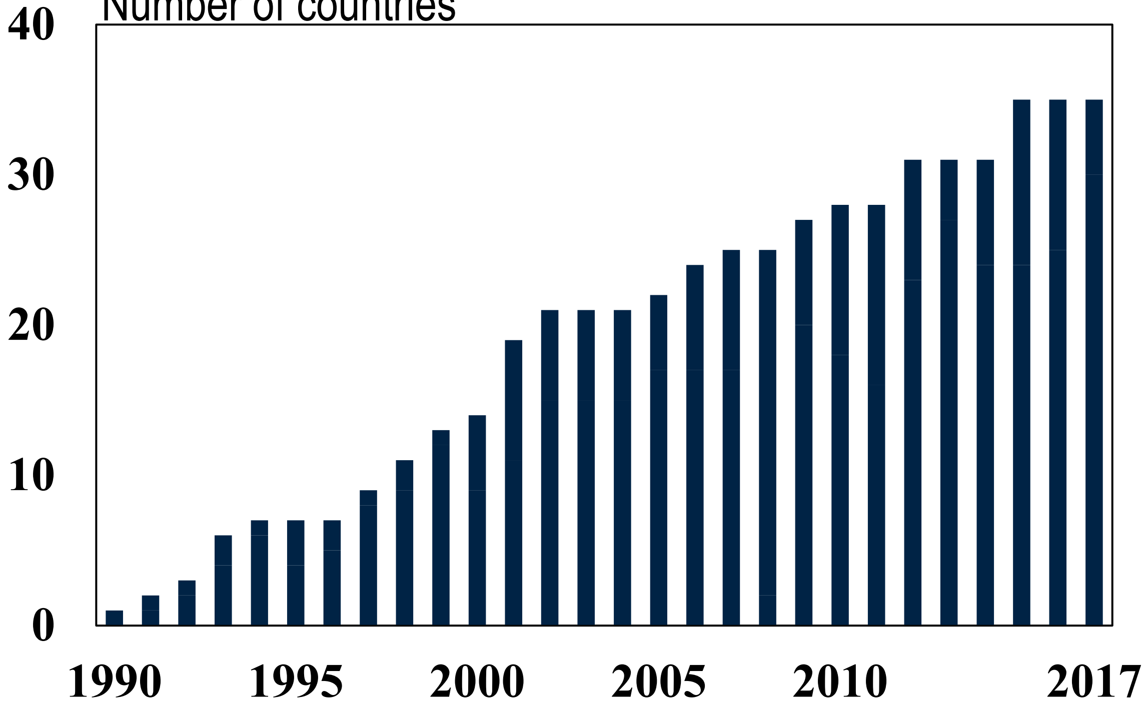
LAC central banks have higher inflation targets higher than those of advanced economies. LAC inflation convergence (in terms of patterns) is probably driven by changes in policy frameworks. Consider a systematic empirical approach to assess the extent and drivers of convergence (some statistical features and regressions with policy variables)

Inflation targets in LAC and advanced economies



Countries with inflation targeting regimes

Number of countries



Source: World Bank; Ha, Kose, and Ohnsorge (2019).
Note: Left panel. Inflation target in 2023. Red bars indicate advanced economies, blue bars EMDEs including LAC. Dashed lines refer to cross-country average of each country group. Right panel. Bars indicate the number of countries with inflation targeting regimes.

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2. Drivers of Inflation: Approach
Roles of Fundamental Shocks

- The paper presents three different exercises (Phillips Curve; Local Projections; Taylor rule) analyzing the roles of various factors in driving inflation and policy interest rates.

- Estimate an SVAR model and impose structural restrictions to recover fundamental shocks in an integrated approach to address the different questions the paper addresses.

- Assess the importance of shocks associated with demand/supply, external/domestic, commodity prices, interest rates, terms-of-trade, exchange rates… Consider a global block and domestic block in a multi-country model.

2. Drivers of Inflation: Reasons

Roles of Fundamental Shocks

- **Result:** The recent surge in inflation was driven by inflation expectations.

  Or is it because of shocks associated with supply disruptions and demand shocks driven by fiscal policy?

- **Result.** Output gap contributed less to inflation in 2020-2022 than in the 2006-2008 cycle.

  Or is it because of shocks associated with supply/demand that determines how output and inflation evolve.

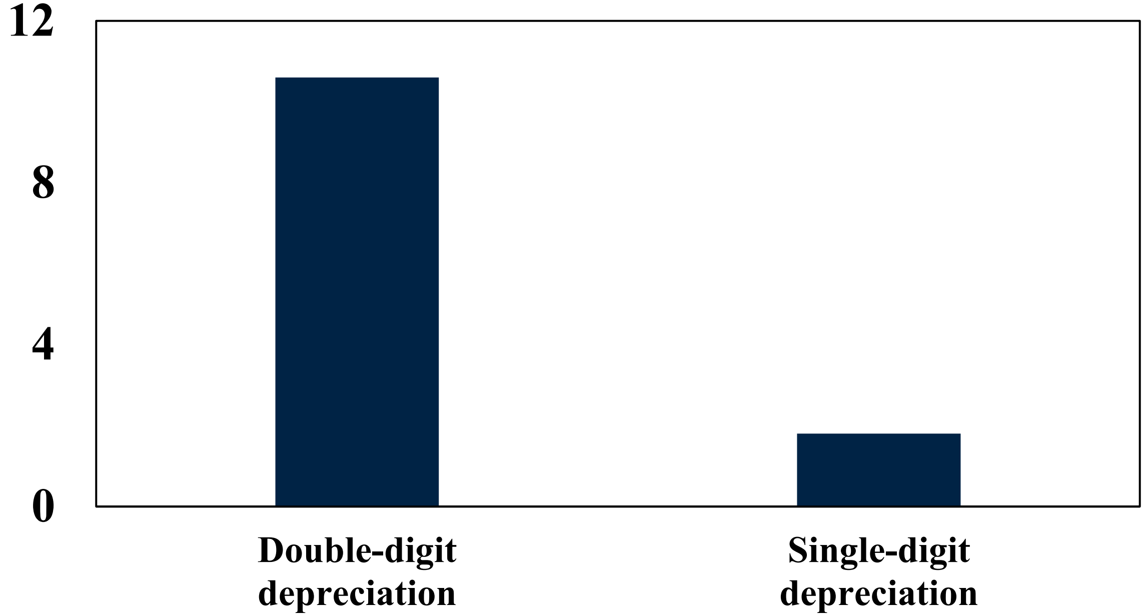
- **Result:** Monetary policy responds more to changes in inflation expectations.

  Or is it because of changes in shocks associated with demand/supply, external/domestic forces?

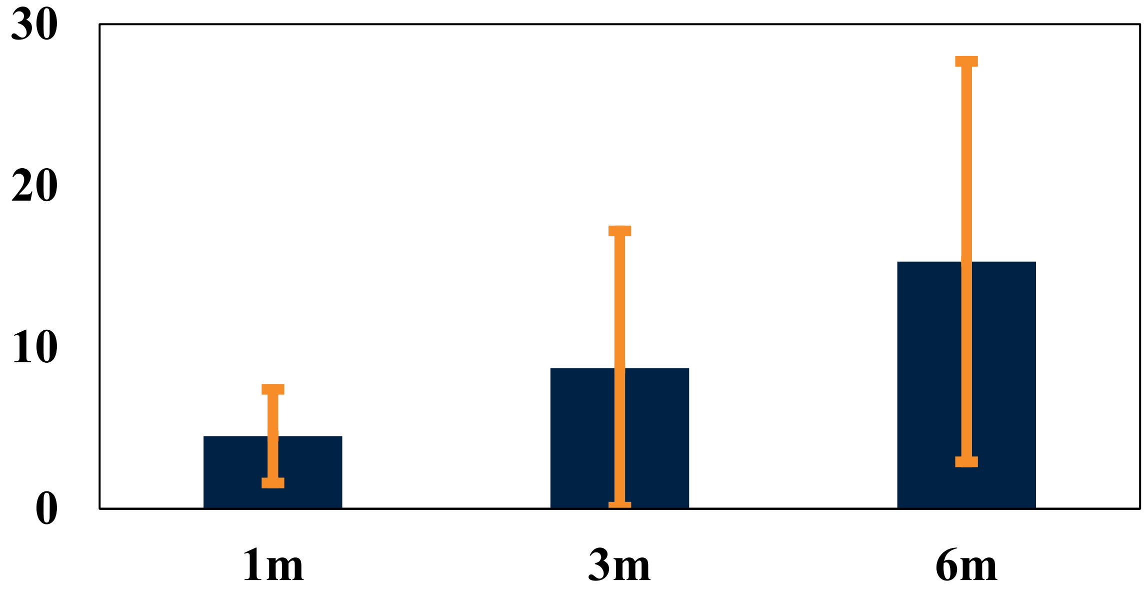
3. Depreciation Driving Inflation and Monetary Policy Response *Relevant…*

The paper focuses on inflation expectations, commodity shocks, and US interest rates (all relevant) to explain inflation and monetary policy responses in different sections. But also need to consider the role played by currency movements

EMDE inflation increase in 2022, by degree of currency depreciation
(Percentage points)



EMDE policy rates after large depreciations
(Basis points)



Sources: Haver Analytics; World Bank.
Note: EMDE = emerging market and developing economy. Left Panel. Average rise in headline consumer price index inflation. "Double-digit depreciation" and "Single-digit depreciation" are relative to the U.S. dollar in 2022. Balanced sample includes 84 EMDEs. Right panel. Bars show estimated impact of a 10-percent monthly currency depreciation at t = 0 on EMDE policy rates at t+1, t+3, and t+6 months horizons using a local projections model. Orange whiskers indicate 90 percent confidence intervals. Sample includes 33 EMDEs with floating or free-floating exchange rates.

4. Questions, Results, and Samples
Less is More…

- The current draft has (*the next draft can have*):
  - ***eleven questions*** in the introduction. *Better to reduce the number of questions.*
  - ***a lot of results***. *Better to focus on the strongest set of results*. *(results about consumption baskets? Results about the responses of core CPI to energy price shocks?)*
  - ***multiple samples and databases in different sections.*** *Better to focus on the same sample and move some results as robustness*
  - ***limited set of robustness exercises.*** Focus on a smaller number of empirical models/results and conduct extensive robustness exercises.

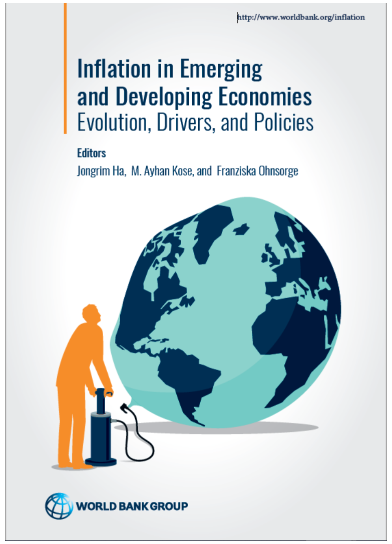
Summary

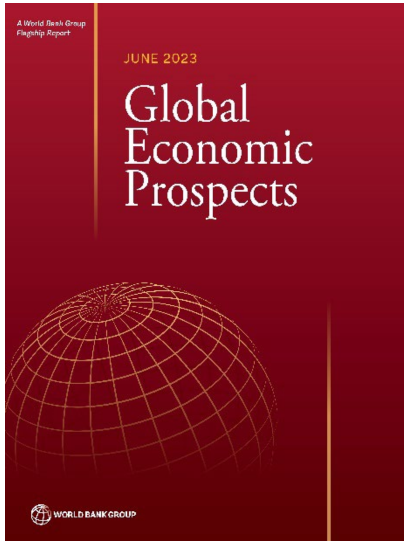
- Ambitious draft with lots of results, models, and samples
- Clear value added in the context of the recent inflation surge and monetary policy responses
- Also shows that we need to conduct more research on LAC (and EMDE) inflation and monetary policy

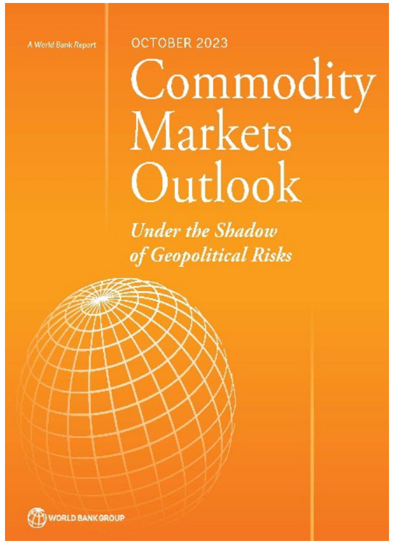
Studies by the Prospects Group on
Inflation and Monetary Policy in EMDEs

Ongoing projects on

- Inflation and commodity prices
- Monetary policy transmission
- Monetary policy spillovers
- Monetary policy uncertainty
- Inflation uncertainty
- Firm-level determinants of prices







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