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Rate Cycles

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2024 ECB Sintra Forum

Discussion

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The WWW of the contribution

WHAT? Differences and similarities among monetary policy cycles across countries (24 OECD economies) and over time (from 1970 to 2024).

WHY? This time (2020-24) feels different.

HO**W**? (i) dynamic factor models on an international panel to identify GLOBAL regularities.
(ii) factor-augmented structural vector auto regressions to interpret them.

AND SO, WHAT?
1. Over time, monetary policy cycles have become more synchronized across countries.
2. Expansion phase of the cycle tends to last longer than the tightening one.
3. 2020-24 rate cycle: (i) unprecedented in both tightening and holding synchronization,
   (ii) increased role for global supply shocks, but global demand shocks still dominant.

Assessment: **W**OOOOOOOOOOOO**WW**

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Plan of the discussion
How many elephants can fit in a room?

1. The Good, (aka wages)
2. the Bad… (aka services)
3. …and the Ugly (aka fiscal policy)

Bansky, 2006, California

Self imposed constraint:
Only descriptive; same statistical tools and countries (roughly) as the authors

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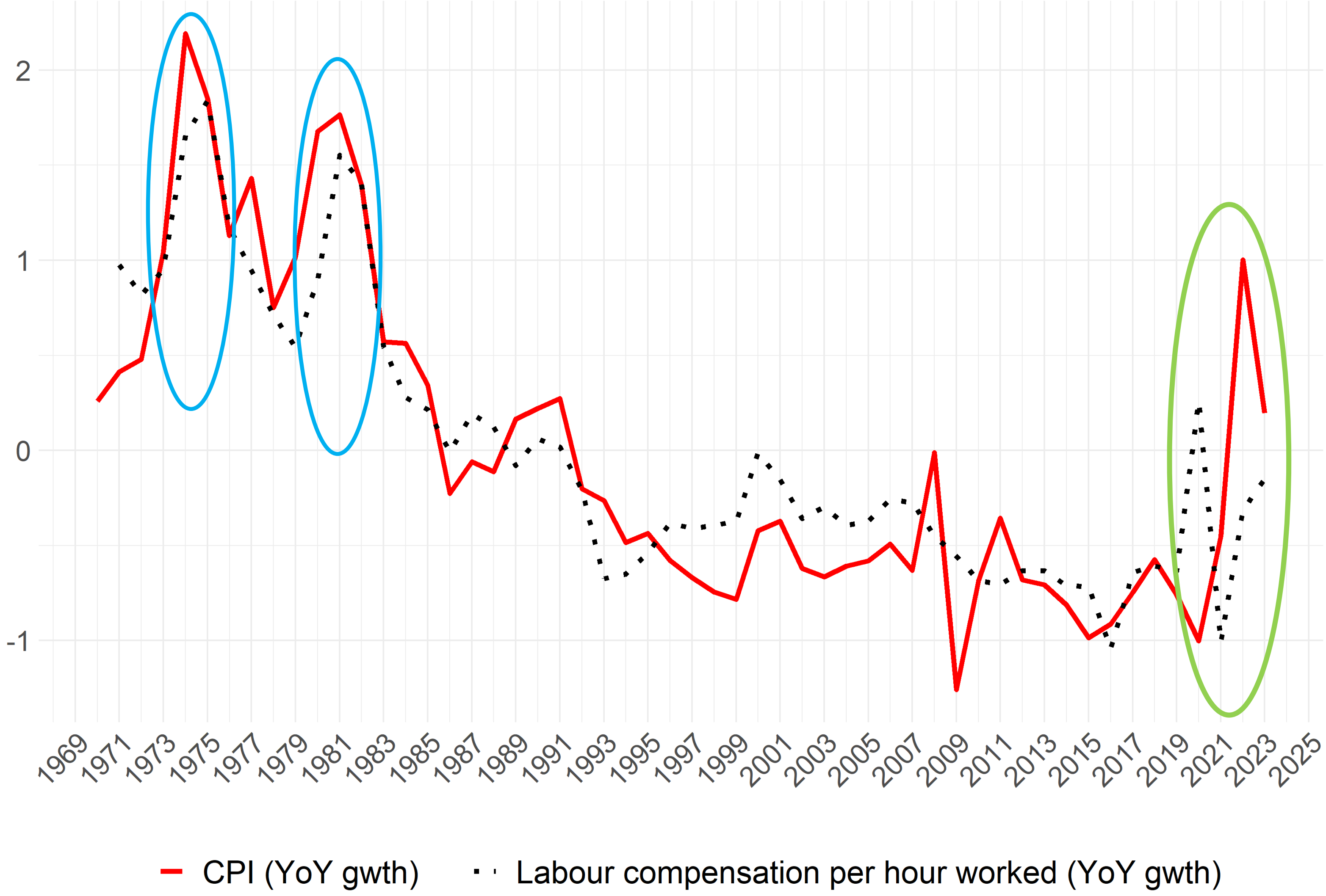
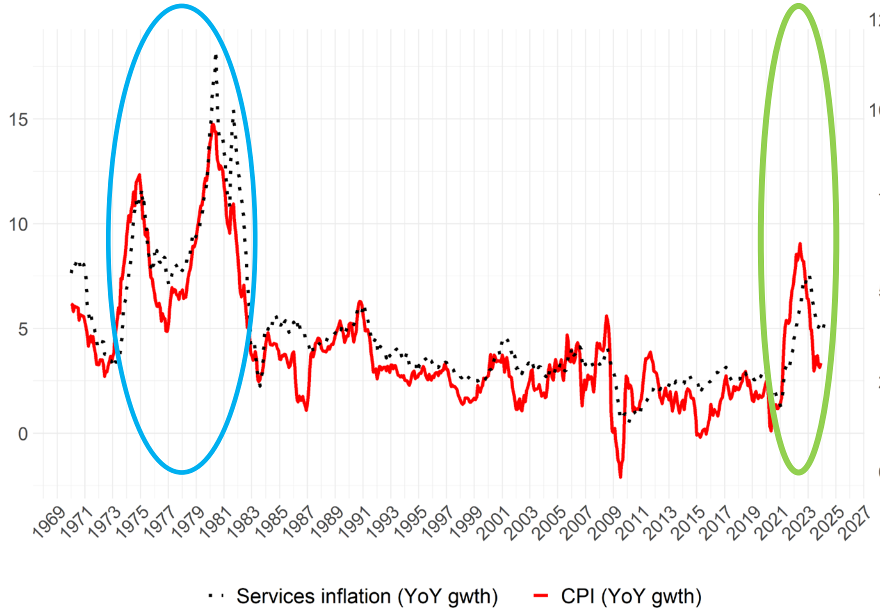
1. Global Wage Growth

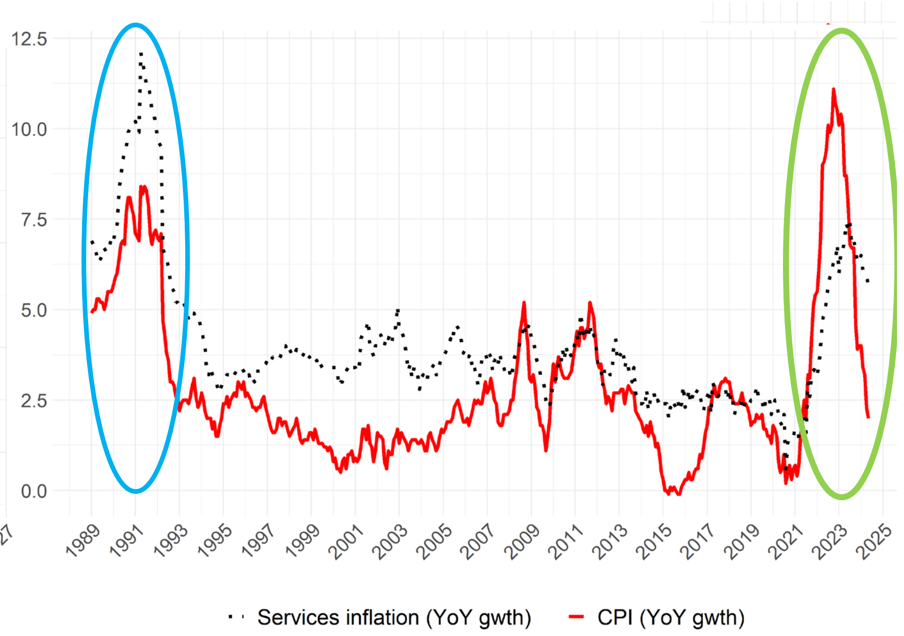


2. Global Services Inflation

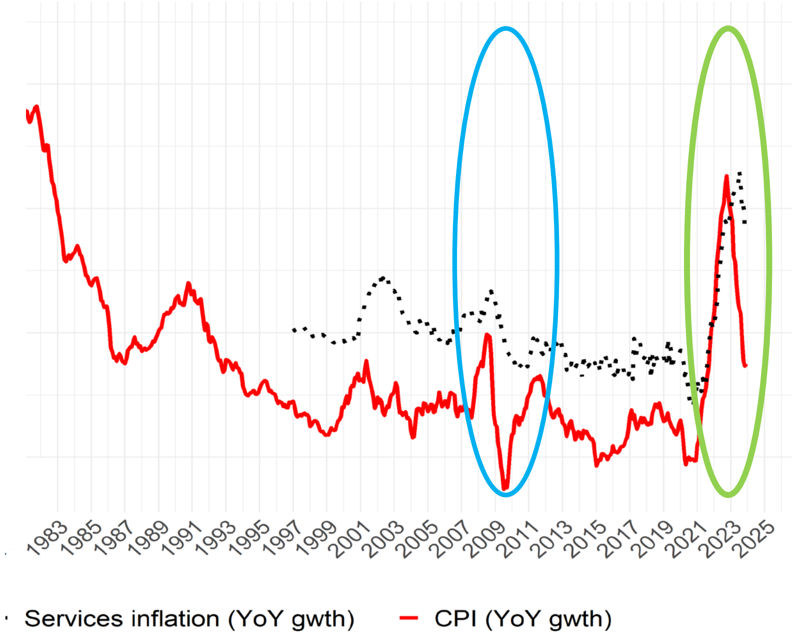
United States



United Kingdom



Euro-Area (PC)



In previous cycles: CPI inflation and service inflation have been highly synchronized.

2020-24: service inflation peaked one year later, and showed more persistent than CPI?

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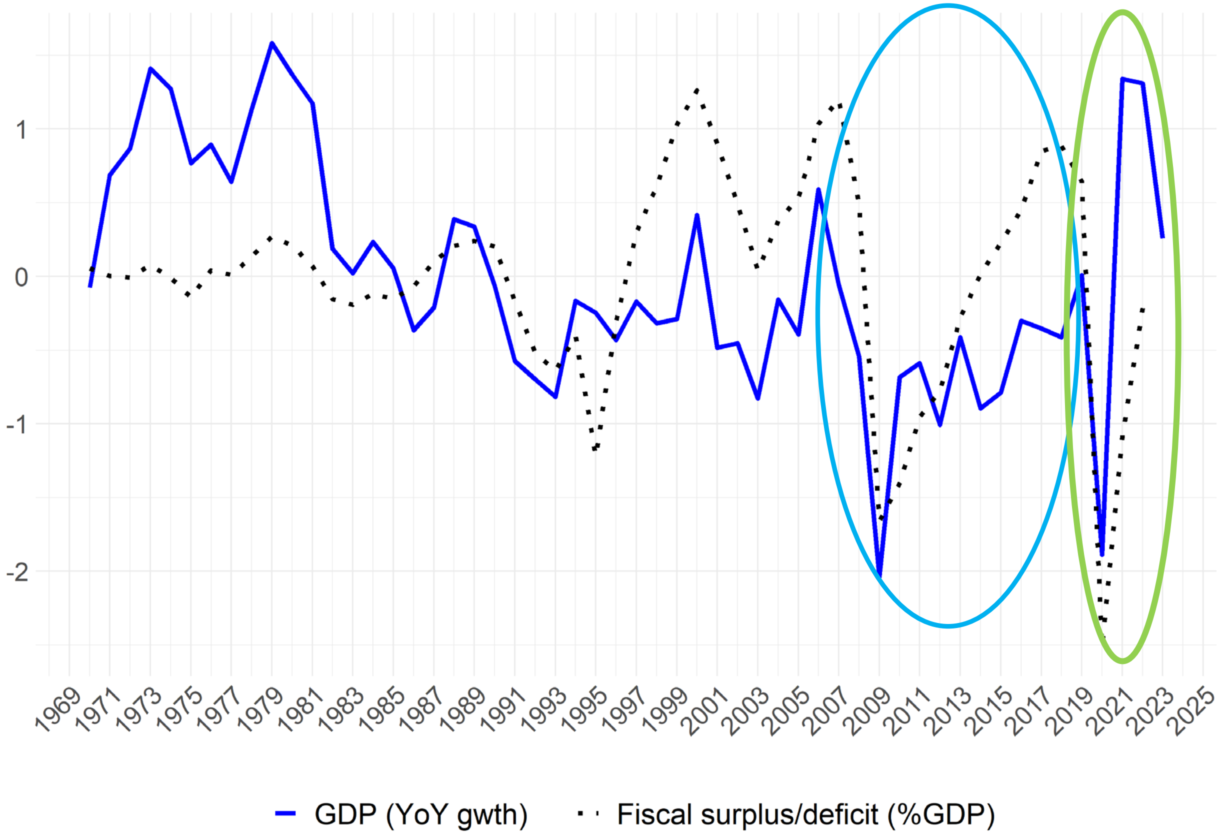
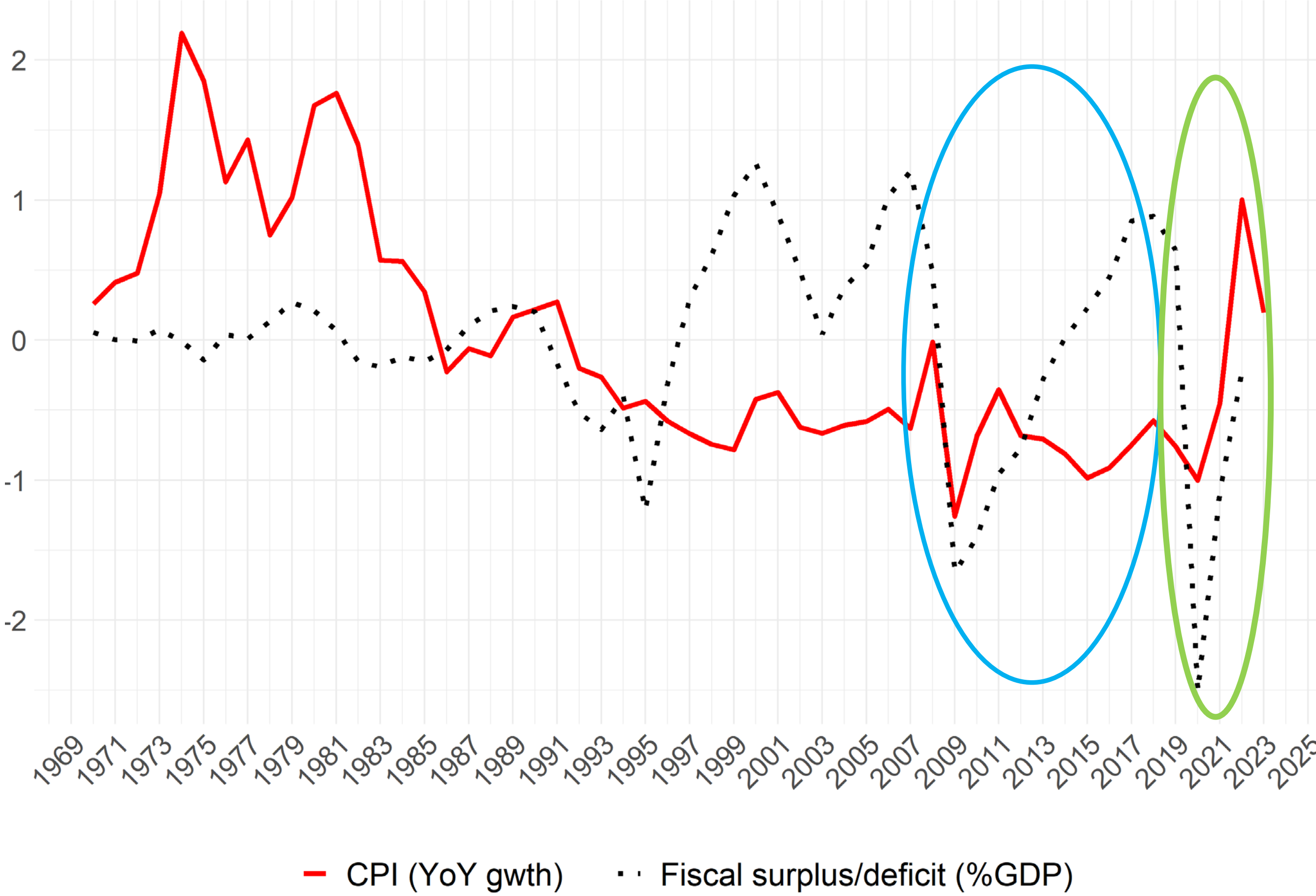
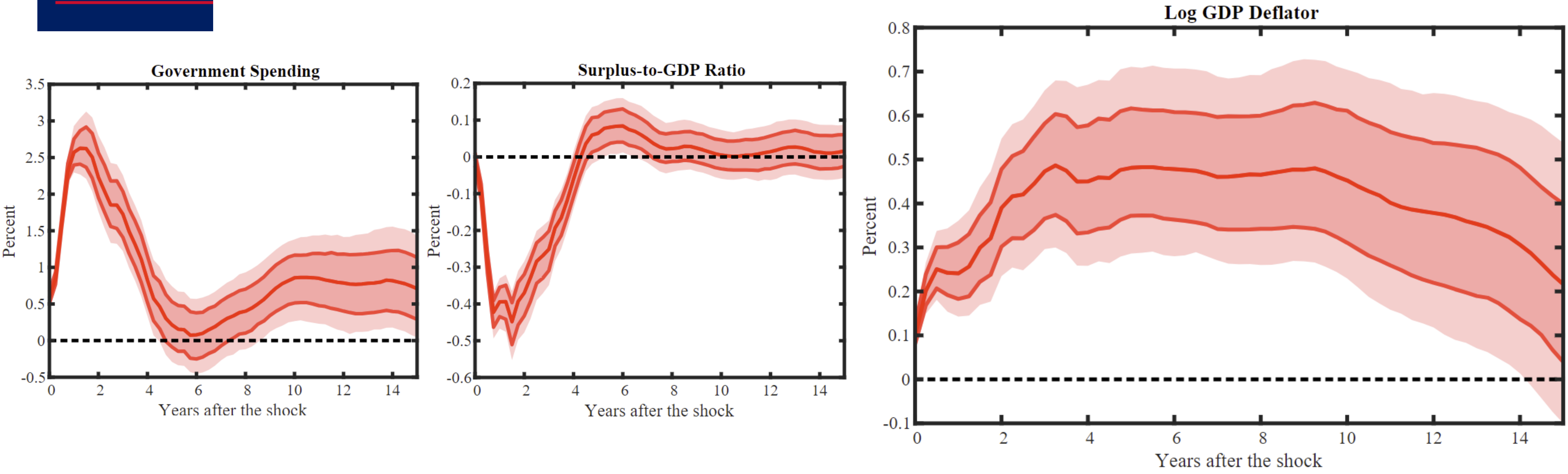
3. Global Fiscal Sustainability





Global financial crisis slow-recovery *versus* Pandemic fast-recovery.

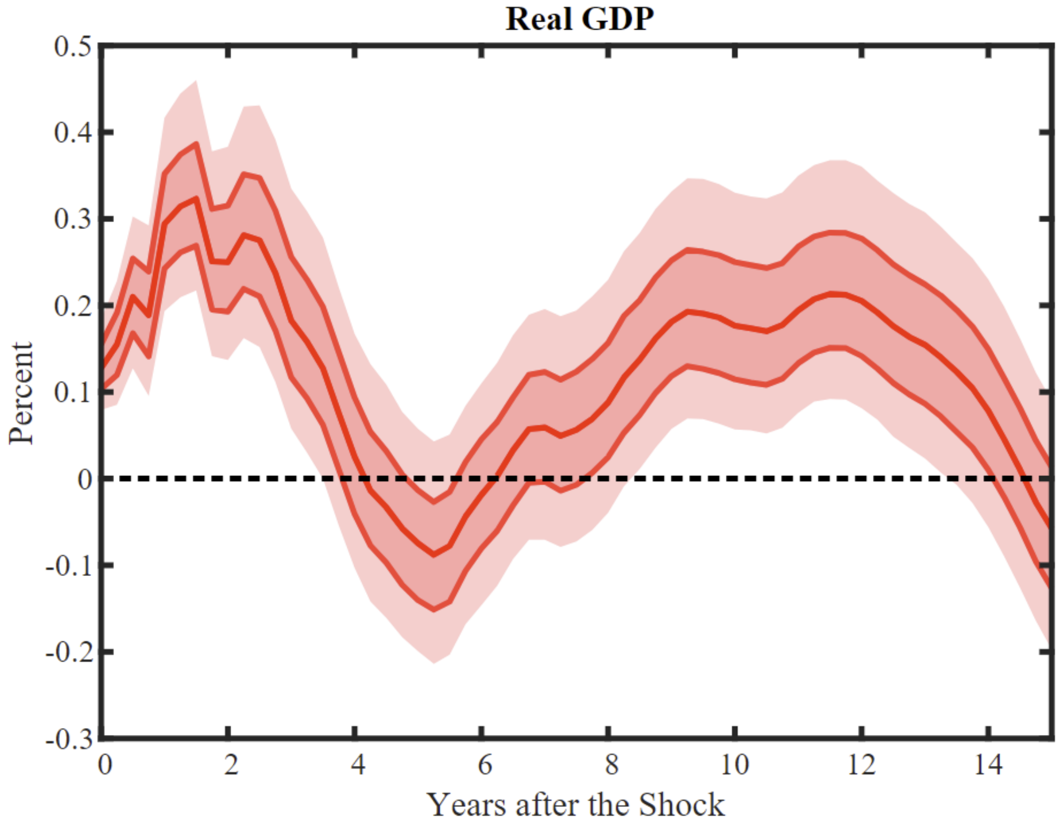
Is Government Spending Inflationary?

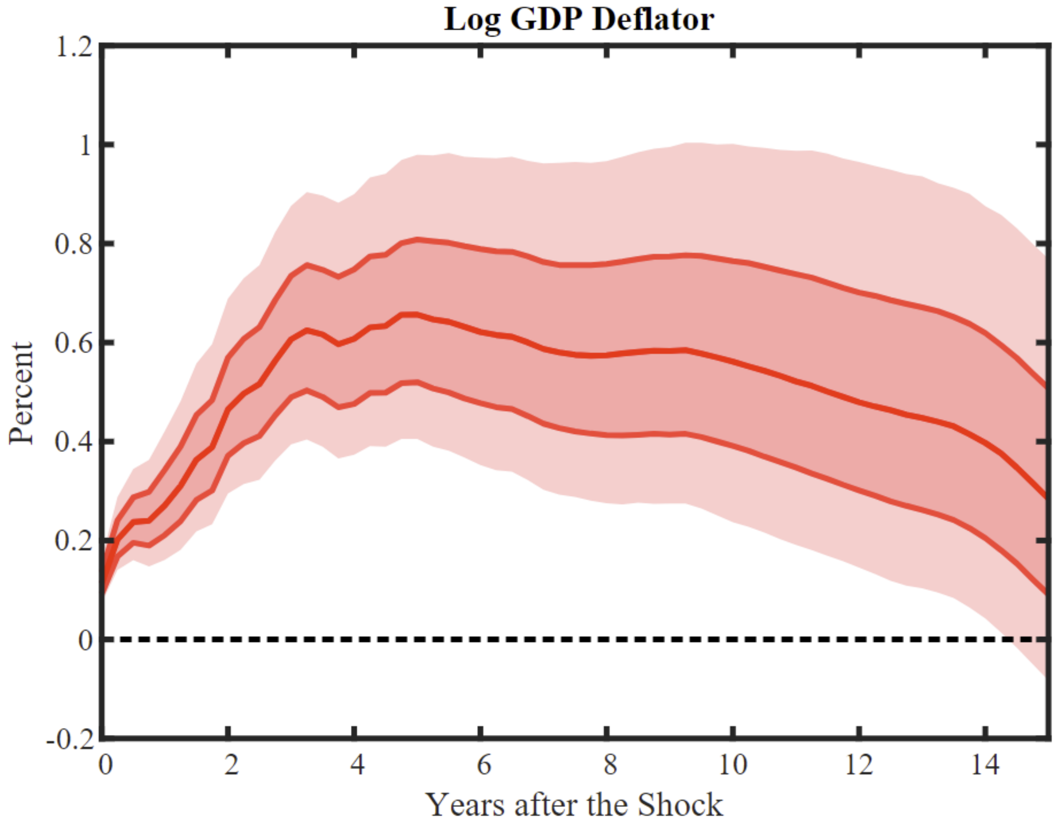


Size of the Government Spending shock: 1% of GDP over the first year after the shock. Sample: 1890 – 2015, United States. BVAR(60).
Back of the envelope: **The 6.5% of GDP increase in EA public spending in 2020 contributed [2.4%, 4%] to EA inflation in 2022-23**.

Source: *"The Long-Run Effects of Government Spending", Antolin-Diaz and Surico, American Economic Review, forthcoming.*
Instrument for government spending: U.S. military spending news from Ramey and Zubary, 2018, Journal of Political Economy.

Btw, is government spending a demand or a supply shock?





Looks like a demand shock in the short-run (positive comovement between inflation & output) but like a supply shock in the long-run.

Source: *"The Long-Run Effects of Government Spending", Antolin-Diaz and Surico, American Economic Review, forthcoming.*
Instrument for government spending: U.S. military spending news from Ramey and Zubary, 2018, Journal of Political Economy.

Concluding Remarks

- Two possible pitfalls in our current macroeconomic thinking: i) demand shocks vs supply shocks; ii) short-run vs long-run.
- Perhaps this thinking contributed to downplay the role of structural reallocation and fiscal sustainability in the recent inflation episode?
- Lack of available evidence did not help either…
- …however, recent research suggests that the contribution of fiscal policy to the recent inflation scare might have been overlooked.