"Monetary Policy during Unbalanced Global Recoveries"

by Luca Fornaro and Federica Romei

Discussion by
Omar Rachedi
ESADE Business School

Banco de España Annual Research Conference
December 2, 2022

This Paper in a Nutshell

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  (ii) Households dislike total consumption inflation.

  (iii) Nominal wage and non-tradable price are fixed in the short run (first period);

  (iv) DRS in tradable production $\rightarrow$ partially flexible price in the short run;

  (iv) Long run $\rightarrow$ constant stream of tradable and non-tradable endowments.

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- Study the implications of a one period shift in preferences towards tradables.
- Uncover optimal monetary policy under financial autarky and free capital mobility.

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- Reallocation shock raises inflation (tradables) & unemployment (non-tradables).
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  - Global reallocation shock:
    - Unilateral expansions ease foreign demand imbalances w/ domestic inflation costs.
    - Deflationary bias can be offset by international cooperation.

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- Must read for three reasons:
  1. Uncovers the role of international cooperation in times of strong global demand and high inflation. It mirrors the insights of their 2019 AER paper which looks at the role of cooperation when demand is scarce and inflation is low.
  2. Helps inexpert readers like myself to get all the quite complicated dynamics.
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  3. Showcases how we should write papers.
- I will mainly try to connect the results of this paper to those of Guerrieri et al. (2021). And will end up with a bunch of unfair comments.

Asymmetric Demand Shocks and Monetary Policy

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    - ⋆ Aoki (2001): with one sticky-price and one flexible-price sector, optimal policy targets inflation in sticky sector and achieves divine coincidence.

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    - ⋆ Aoki (2001): with one sticky-price and one flexible-price sector, optimal policy targets inflation in sticky sector and achieves divine coincidence.
  - Downward wage rigidity: divine coincidence fails $\rightarrow$ inflationary bias.
    - ⋆ Asymmetric demand shock looks like a cost push shock as it leads to inflation and unemployment.

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  - Monetary easing raises demand for non-tradables, reducing unemployment, but reduces the incentives for workers to change sector.
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  - Wasteful unemployment stimulates workers reallocation towards tradables.
- Downward wage rigidity and sticky prices: expansionary bias.
  - Workers reallocation raises wages in the tradable sector.
  - Unemployment is no longer the only way to boost reallocation.
  - Higher wages and prices in tradables are optimal.

Monetary Policy and Reallocation: The Role of Labor Mobility

- In this paper, perfectly mobile labor shuts down these mechanisms.
- How would optimal monetary policy change by allowing for costly labor mobility?
  - It would be interesting to generalize the results of Guerrieri et al. (2021) to an open-economy case.
  - Similar spirt to Farhi and Werning (2014), with a congestion externality in a model of a monetary union in which workers can move between countries.
  - In case of the existence of a contractionary bias in optimal policy, would international cooperation help in mitigating it?

Asymmetric Price Rigidity between Tradables and Non-Tradables

- Non-tradable prices are fixed in the short run, and only tradable prices adjust.
- I computed a weighted average price duration for tradables/non-tradables in the U.S.
  - Consider 3-digit NAICS disaggregation level.
    (66 industries)
  - Use 2019 BEA Input-Output Tables to define if a sector is tradable.
    (If exports account for more than 5% of its total gross output)
  - Use the price frequency probabilities of Pasten, Schoenle and Weber (2020).
- Price duration for tradables is 5.5 months, whereas it is 6.5 months for non-tradables.

Relevance of the Mechanism (and a Bunch of Unfair Questions)

- Luca and Federica elegantly showcase the relevance of international cooperation in dealing with asymmetric global demand shocks.
- How quantitatively relevant is the deflationary bias due to lack of policy cooperation?
- To what extent we should think at this question in a setup similar to recent firm dynamics models, in which the economy consists of few dominant price-maker players and a fringe of price takers?
- How to think about the coexistence of excessive demand with supply chain disruptions, which limit the balancing of supply and demand even when production can be optimally allocated across sectors?

Thank you!