Discussion of Maury Obstfeld’s
Global Dimensions of US Monetary Policy

Monetary Policy Strategy, Tools & Communication Practices
A Fed Listens event
Federal Reserve Bank of Chicago
June 4-5, 2019
Federal Reserve Mandate:
- U.S. employment
- U.S. price stability
- (U.S. long-term interest rates)
Many Potential Linkages

- US inflation process
- International financial linkages
- Role of dollar
- Global supply chains / markups
- Commodity markets
- Global capital flows
- Global financial stability

Source of globe image: https://www.evl.uic.edu/pape/Gallery/PreLit.html
Obstfeld: Key Points

• Overall: skeptical lens

• Key parts of analysis:
  • US inflation process: more skeptical
  • International financial linkages: important role of global factor in r* and current accounts
  • Dollar’s global role: important “spillbacks” through dollar invoicing and funding

• Conclusions
  • Global influences matter
  • Can complicate monetary policy; “divine coincidence” less likely
  • “much we still need to learn”
  • An integrated picture of this “elephant” remains elusive
Part I:
The Inflation Process
Global Aspects of US Inflation Process

- **3 main channels:**
  - Global competition
  - Wage behavior
  - Foreign prices

- **Important contribution: context of simple models**
  - Phillips curve: shifts vs. slopes
  - Can be counteracting effects
  - Bottom line: empirical estimates needed

- **Obstfeld results: correlates of US CPI**
  - Declining role of domestic wages and labor productivity
  - Mixed evidence on role of import prices (↑ post-2007)
  - **Unresolved: what explains the large residuals?**
• More work needed!

• Some gaps:
  • Changing role of global environment over time—dates matter
  • Changing role of markups/global competition?
    • Jackson Hole 2018 symposium papers: Van Reenen, Crouzet & Eberly, Philippon
  • Changing role of exchange rates?
    • Forbes, Hjortsoe & Nenova (2018), Ha, Stocker & Yilmazkuday (2019)
  • Changing role of commodity prices?
    • Miles et al. (2017), World Bank (2018), Coibion & Gorodnichenko (2015)
Greater Role for Commodity Prices?

Notes: Fraction of variance of different inflation measures explained by 1st principal component for relevant measure of inflation. All measures of inflation are quarterly, annualized and seasonally adjusted. Wages is a measure of private-sector wage growth. Sample of 31 advanced economies. Source: Forbes (2019, forthcoming BPEA)
Implication

- One variable for “import prices” not enough

- Should better isolate different global influences
  - Commodity prices (oil and others)
  - Exchange rate effects
  - Foreign output gap
  - Global supply chains/global competition
Expanded Model

\[ \pi_t = \alpha_1 \pi_t^e + \alpha_1 \pi_t^L + \beta GAP_t^D + \text{Constant} + \epsilon_t \]

\[ + \gamma_1 ER_t + \gamma_2 GAP_t^F + \gamma_3 Oil_t^W + \gamma_4 Comm_t^W + \gamma_5 PriceDisp_t^W \]

\( \pi_t \): CPI inflation (quarterly, annualized & seasonally adjusted)
\( \pi_t^e \): inflation expectations
\( \pi_t^L \): lagged inflation
\( GAP_t^D \): domestic output gap
\( GAP_t^F \): foreign output gap
\( ER_t \): \( \Delta \) in trade-weighted exchange rate
\( Oil_t^W \): oil price inflation (relative to CPI)
\( Comm_t^W \): commodity (ex. energy) price inflation (relative to CPI)
\( PriceDisp_t^W \): price dispersion in PPI in sample

43 advanced economies and emerging markets, 1990-2017
Errors in Phillips Curve Model

CPI Inflation, 43 countries

Source: Figure 5(a) in Forbes (2018), paper prepared for BIS.

Notes: Graph shows median value of the squared deviation between actual and predicted inflation each quarter when Phillips-curve equation is estimated with 8-year rolling regressions. “Only Domestic Variables” is when the model only includes controls for inflation expectations, lagged inflation, and the domestic output gap. “Domestic + Global” adds 5 global variables.
Part II: International Financial Linkages
International Financial Linkages

• Paper focuses on 4 main channels:
  • $R^*$
  • Current account balances
  • Real exchange rates
  • Dollar liquidity shocks

• Also important: Implications for net worth & consumer spending → monetary policy
Part III: Spillbacks — Implications of the Dollar’s Global Role
Spillbacks

- Paper focuses on spillbacks through dollar’s role:
  - Dollar invoicing
  - Dollar funding

- But also other potentially important spillbacks:
  - Commodity markets
  - Capital flows
  - Crisis risk in other countries

- Reduced spillbacks recently?
  - Fewer sudden stops and surges in capital flows?
  - Updated episodes, based on Forbes and Warnock (2012)
Reduced Spillbacks through Banking Flows?

Source: Based on updated data and methodology from Forbes and Warnock (2012). Data through 2018Q3.
Final Thoughts
“Much We Still Need to Learn”

What has changed?

US inflation process
International financial linkages
Role of dollar
Global supply chains / markups
Commodity markets
Global capital flows
Global financial stability

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