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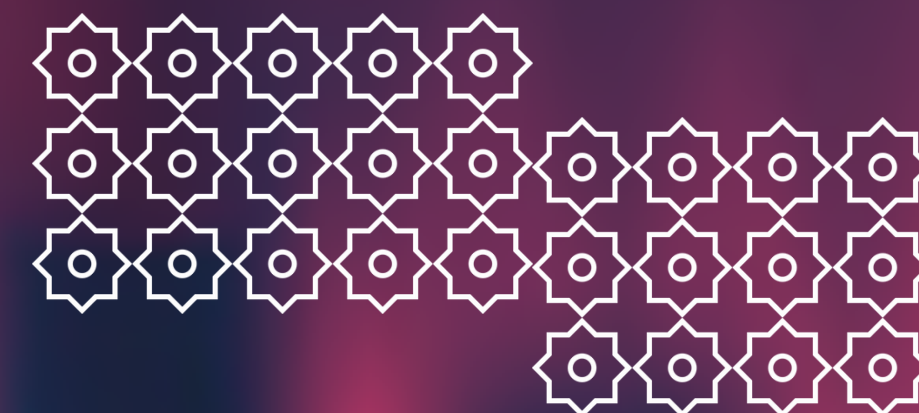
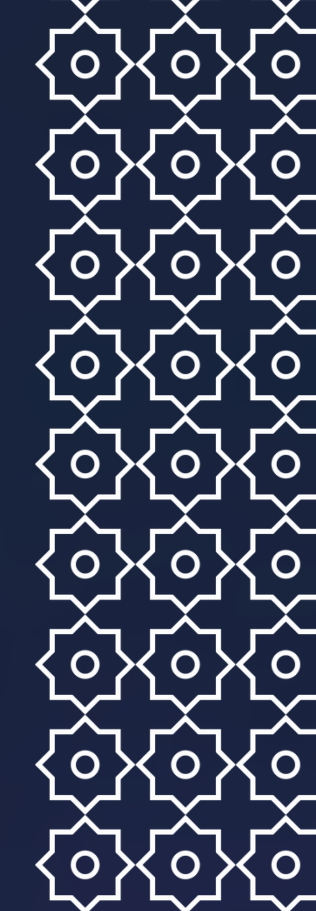


# QATAR CENTRE FOR GLOBAL BANKING & FINANCE ANNUAL CONFERENCE 2024

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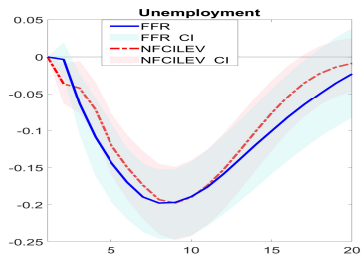
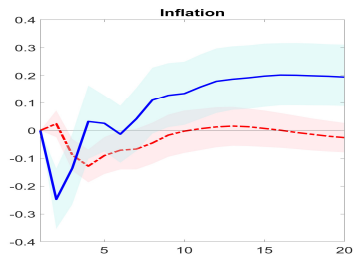
# Does unconventional monetary and fiscal policy contribute to COVID inflation surge?

Jing Cynthia Wu  
*University of Illinois and NBER*

Coauthors: Yinxi Xie (BOC), Ji Zhang (THU)

# Vector Autoregression

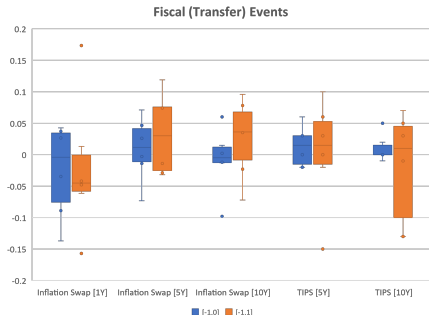
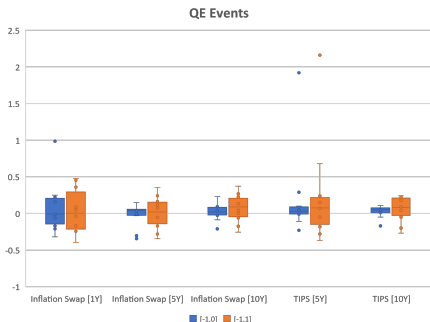
Variables: inflation, unemployment rate, and monetary policy measures



NFCILEV: Leverage Index of the National Financial Conditions Index

- ▷ The inflation response to an unconventional policy shock is smaller
- ▷ The effect of unconventional policy shocks on inflation is basically zero

# Event Study: Great Recession and the COVID-19 pandemic



▷ All the box plots are not statistically different from 0

# Theory

Sims, Wu, and Zhang (*ReStat* 2023) and Wu and Xie (2024):

$$\text{IS curve: } y_t = \mathbb{E}_t y_{t+1} - \frac{\vartheta}{\sigma} (i_t - \mathbb{E}_t \pi_{t+1}) + [qe_t + \tau_t]$$

$$\text{Phillips curve: } \pi_t = \beta \mathbb{E}_t \pi_{t+1} + \gamma \zeta y_t - \frac{\gamma \sigma}{\vartheta} [qe_t + \tau_t]$$

- ▷ The usual demand channel is inflationary
- ▷ The supply channel is disinflationary
- ▷ Unconventional policy works through the leverage channel

# Phillips Curve

$$\text{Phillips curve: } \pi_t = \beta \mathbb{E}_t \pi_{t+1} + \gamma \zeta y_t - \frac{\gamma \sigma}{\vartheta} [q e_t + \tau_t]$$

	Sample: 1990Q1–2019Q2					Sample: 2008Q1–2019Q2		
	(1) OLS	(2) OLS	(3) GMM-GK	(4) GMM-GK	(5) GMM-ES	(6) OLS	(7) GMM-GK	(8) GMM-ES
Un_gap	-0.146*** (0.031)	-0.154*** (0.033)	-0.512*** (0.001)	-0.151*** (0.011)	-0.218*** (0.002)	-0.190*** (0.035)	-0.205*** (0.002)	-0.192*** (0.006)
NFCILEV		-0.055 (0.056)		-0.536*** (0.014)	-0.112*** (0.002)	-0.071** (0.033)	-0.157*** (0.001)	-0.064*** (0.002)
Constant	-0.003*** (0.001)	-0.003*** (0.001)	-0.001*** (0.000)	-0.004*** (0.000)	-0.003*** (0.000)	-0.002*** (0.001)	-0.002*** (0.000)	-0.002*** (0.000)
N	118	118	106	106	100	46	46	46

## Regional PC: Transfers

	Unemployment gap			Output gap		
	(1)	(2)	(3)	(4)	(5)	(6)
Economic slack	-0.745** (0.363)	-0.751** (0.359)	-0.762 (0.519)	0.070*** (0.015)	0.066*** (0.014)	0.047 (0.152)
Lagged transfer	-0.199 (0.122)	-0.230* (0.116)	-0.420*** (0.142)	-0.394*** (0.130)	-0.408*** (0.124)	-0.414*** (0.145)
Inflation expectation		3.475*** (1.157)	2.638 (1.752)		2.902** (1.217)	2.520 (1.791)
Constant	7.759*** (2.693)	-1.353 (4.454)	0.574 (5.096)	2.409** (0.943)	-5.194 (3.368)	-4.832 (7.460)
<i>N</i>	303	303	303	303	303	303
Time FE	No	Yes	Yes	No	Yes	No
State FE	No	No	Yes	No	No	Yes

# Regional GE

	(1)	(2)	(3)	(4)
$\Delta$ Transfer	0.369 (0.291)	0.352 (0.320)	0.409 (0.272)	0.428 (0.285)
Lagged inflation			-0.201* (0.107)	-0.376*** (0.125)
Constant	3.152*** (0.932)	3.206*** (0.814)	-2.397 (3.004)	-2.591 (3.166)
N	303	303	201	201
Time FE	Yes	Yes	Yes	Yes
State FE	No	Yes	No	Yes





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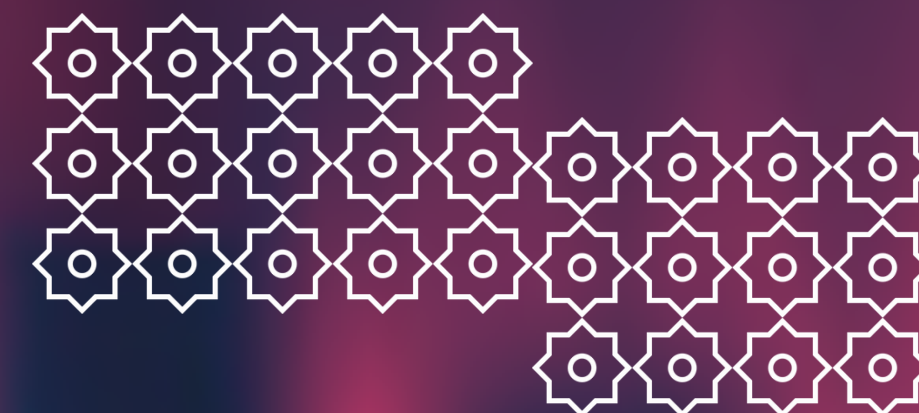
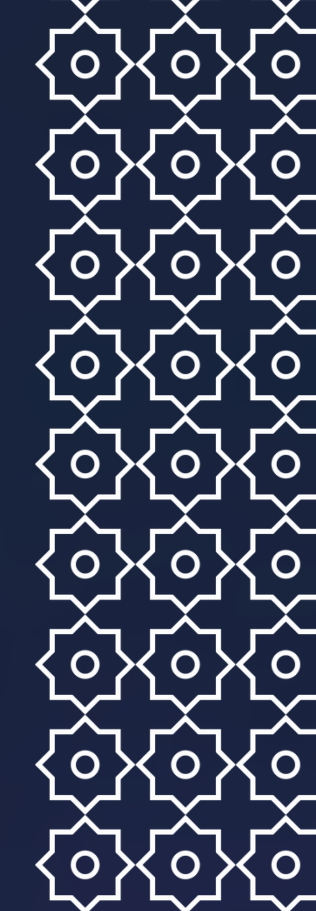


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# Inflation – what (if anything) have recent years taught us?

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Leonardo Melosi

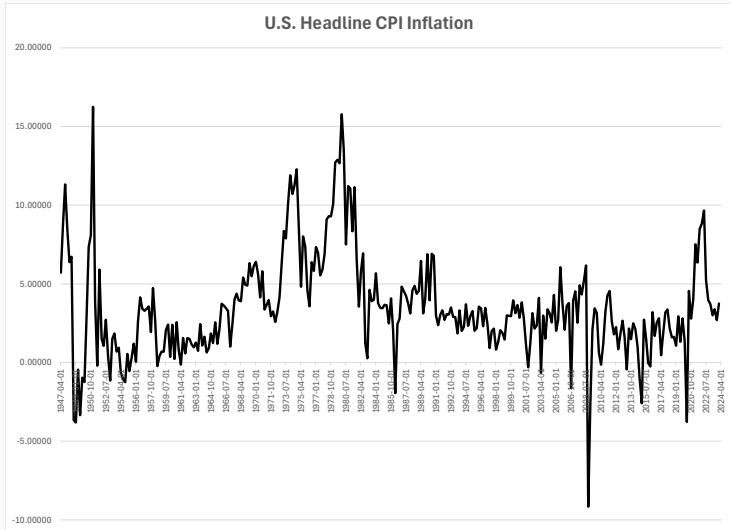
University of Warwick, DNB, FRB Chicago, and CEPR

July 1 2024

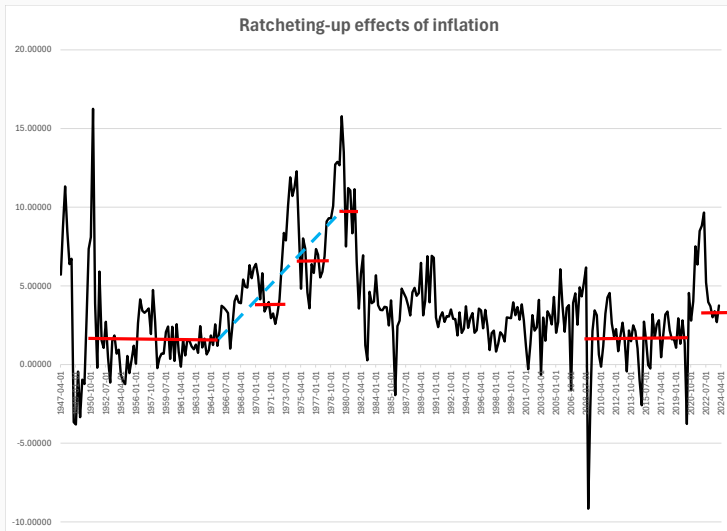
King's Business School - Qatar Center for Global Banking & Finance

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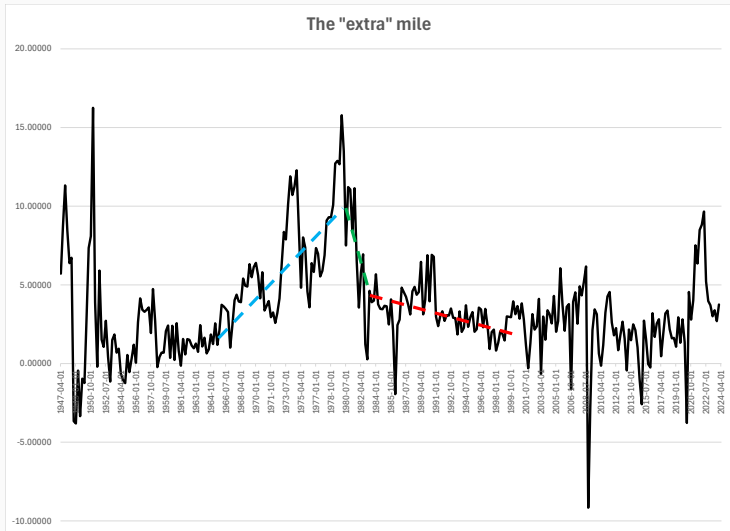
# U.S. CPI Inflation



# Ratcheting-up effects of inflation



# The “extra” mile



# A forecasting model of inflation

- We can make this analysis a bit more sophisticated using the forecasting model by De Polis, Melosi, and Petrella (2024)
- This model allows us to decompose the predicted inflation rate into
  - ① Changes in the balance of risks
  - ② Changes in the central scenario/mode
- The model allows macro-financial variables to predict changes in these moments

# Drivers of inflation

- Changes in the balance of risk affects inflation

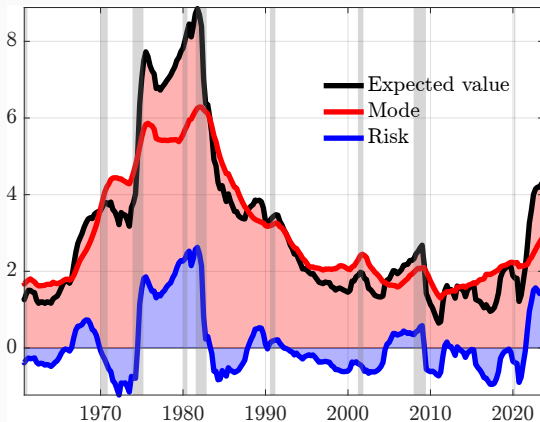


Figure 1: De Polis, Melosi, and Petrella (2024).

# Drivers of inflation

- Changes in the central scenario appear to be more persistent

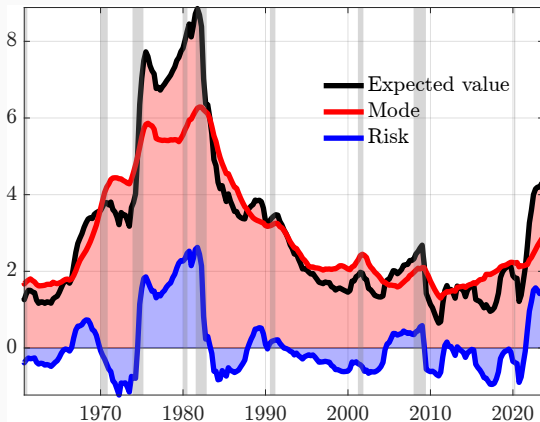


Figure 1: De Polis, Melosi, and Petrella (2024).



# Drivers of inflation

- It took 15 years to bring the mode back to 2 %

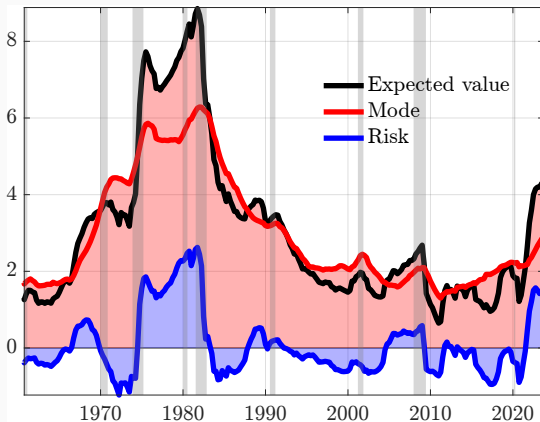


Figure 1: De Polis, Melosi, and Petrella (2024).

# Drivers of inflation

- After the pandemic, inflation higher because both risk and mode have increased

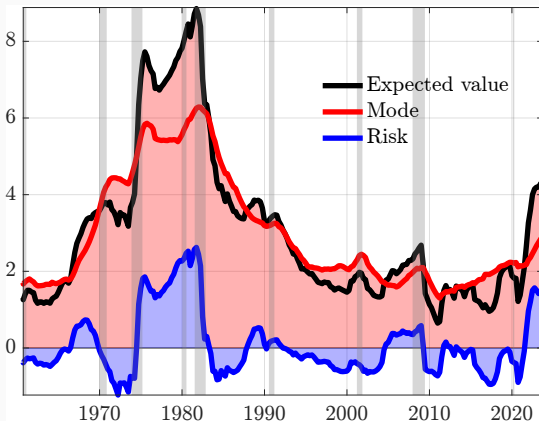


Figure 1: De Polis, Melosi, and Petrella (2024).

# Drivers of inflation

- If macro volatility does not subside, risk will remain a key inflationary factor

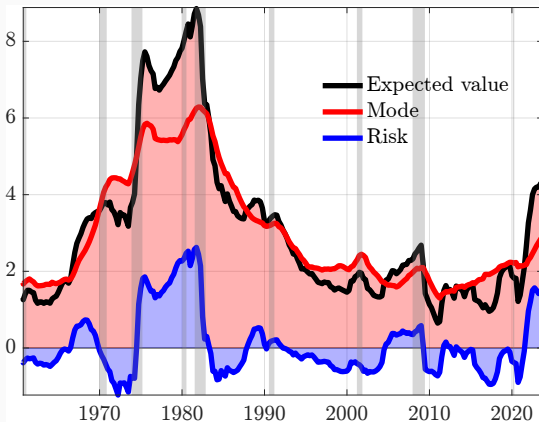


Figure 1: De Polis, Melosi, and Petrella (2024).

# Drivers of inflation

- However, it is the change in the central scenario that should worry us the most

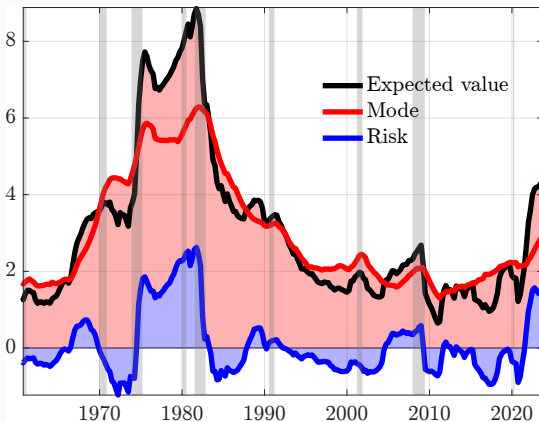


Figure 1: De Polis, Melosi, and Petrella (2024).

# Drivers of inflation

- What are the economic costs of securing the last mile?

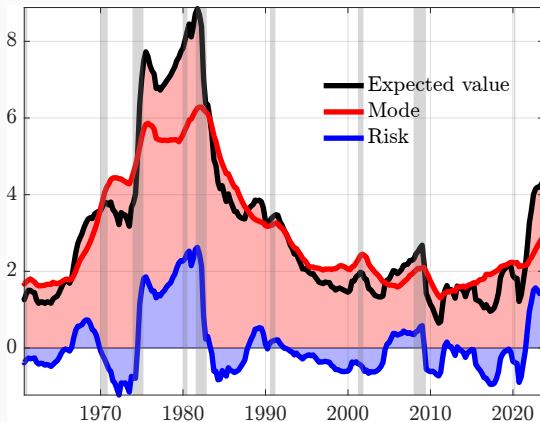


Figure 1: De Polis, Melosi, and Petrella (2024).

# The cost of the last mile

Table 1: The cost of the last mile

	2023	2024	2025	2026	2027
Baseline forecast					
$\pi$	3.83	3.57	3.38	3.28	3.24
Scenario forecast					
$\Delta$ ULC	3.36	3.19	2.96	2.70	2.41
Unemp	3.58	4.31	4.74	5.98	4.93
$\pi$	3.83	3.32	2.92	2.36	2.02

## Waning fiscal backing in the US?

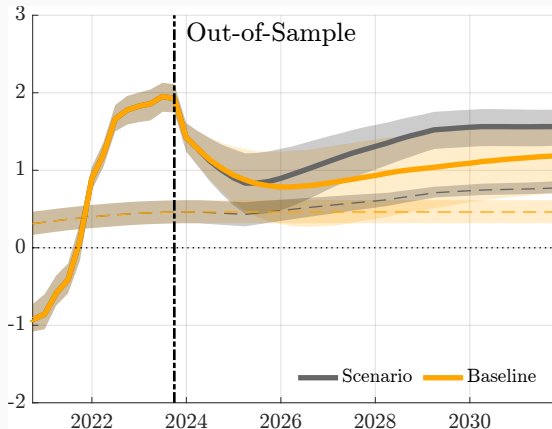


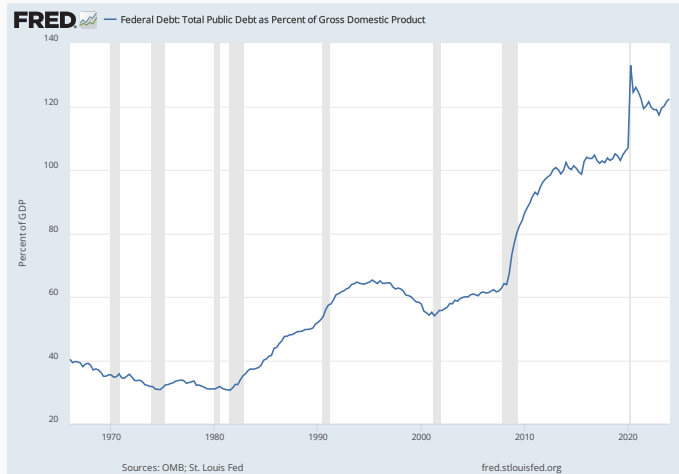
Figure 2: De Polis, Melosi, and Petrella (2024).

## Appendix

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# US Debt-to-GDP ratio





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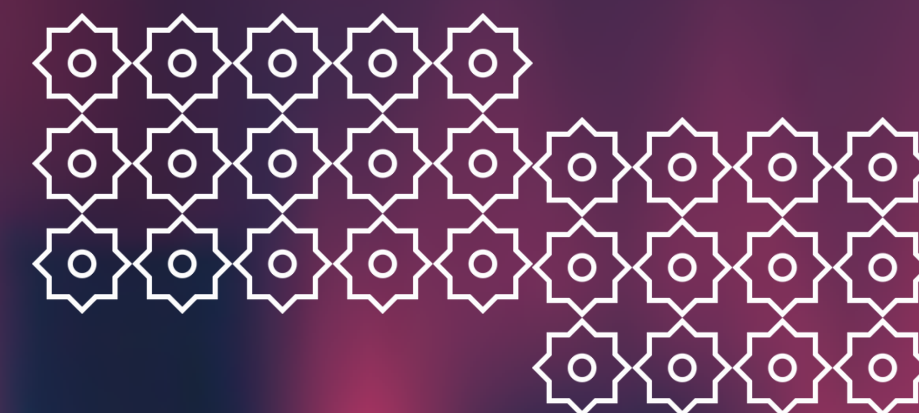


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# QCGBF 4<sup>th</sup> Annual Conference

## – *Inflation Panel* –

Remarks by Egon Zakrajšek  
*Federal Reserve Bank of Boston*

King's Business School  
London July 1, 2024

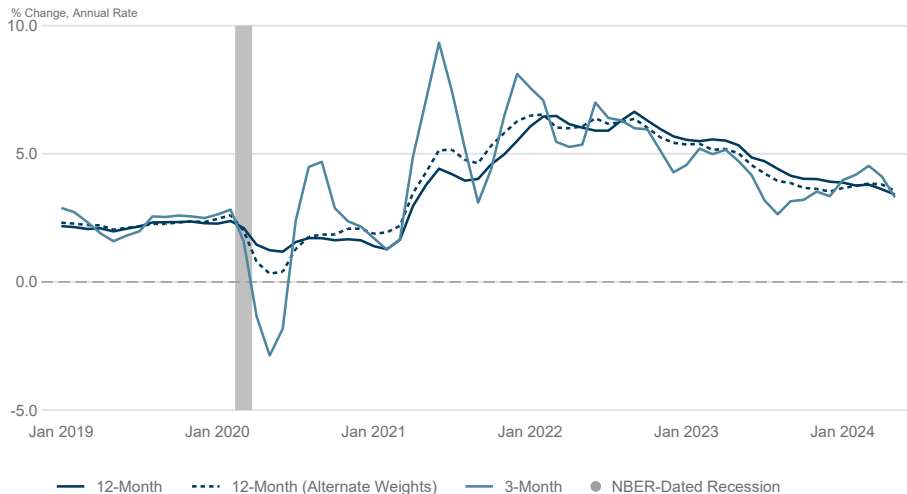


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## Main themes

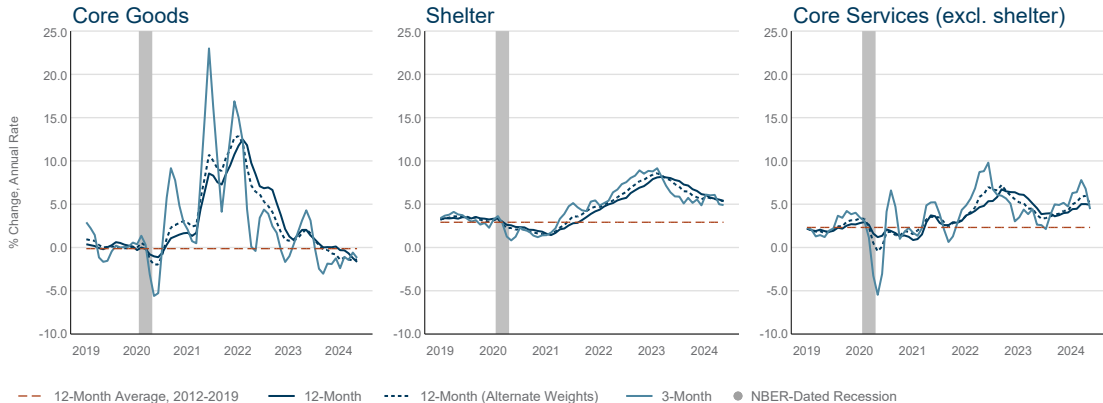
- Has the (U.S.) disinflation process stalled?
- What's the “last mile” impediment? Sticky shelter inflation, robust wage growth?
- My take:
  - ▶ It hasn't stalled – inflation is on track to return to target.
  - ▶ The slow (and uneven) progress is to be expected.
  - ▶ Disinflation is underpinned by
    - ▶ anchored inflation expectations
    - ▶ (moderately) restrictive stance of monetary policy
  - ▶ But risks there are aplenty ...

# Core CPI inflation



Source: Bureau of Labor Statistics / Haver Analytics / Author's Calculations

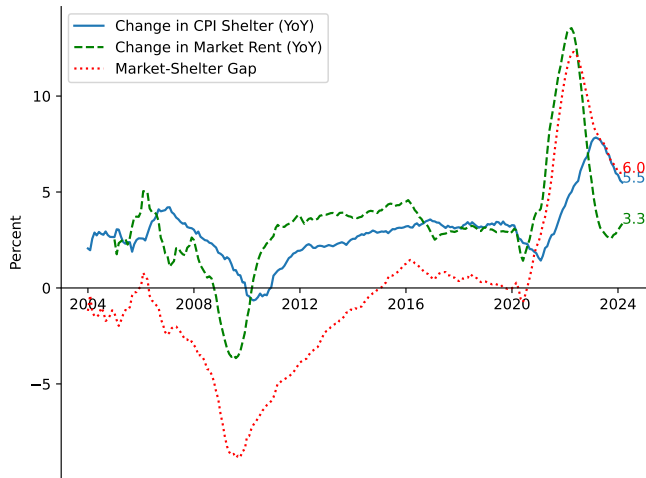
# Main components of core CPI inflation



Source: Bureau of Labor Statistics / Haver Analytics / Author's Calculations

# What's going on with CPI shelter?

Cotton, C. D., *Current Policy Perspectives*, 2024-4 (June 17, 2024)

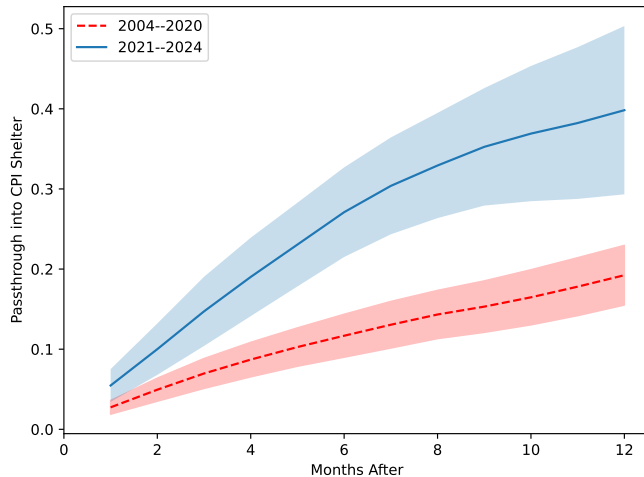


NOTE: The market-shelter gap is set to zero in December 2019.



# Estimated pass-through of market-shelter gaps

Pre- vs. post-pandemic



NOTE: Shaded bands denote the 95-percent confidence intervals.

## Implications

- A **positive** market-shelter gap implies that CPI shelter grows faster to catch up with market rents.
- The pass-through market-shelter gaps to CPI shelter is considerably faster now compared with the period before the pandemic.
- All else equal, this will add 0.7 pps. and 0.3 pps. to core CPI and PCE inflation, respectively, over the next 12 months.

# What about wage pressures?



Source: Haver Analytics / Bureau of Labor Statistics

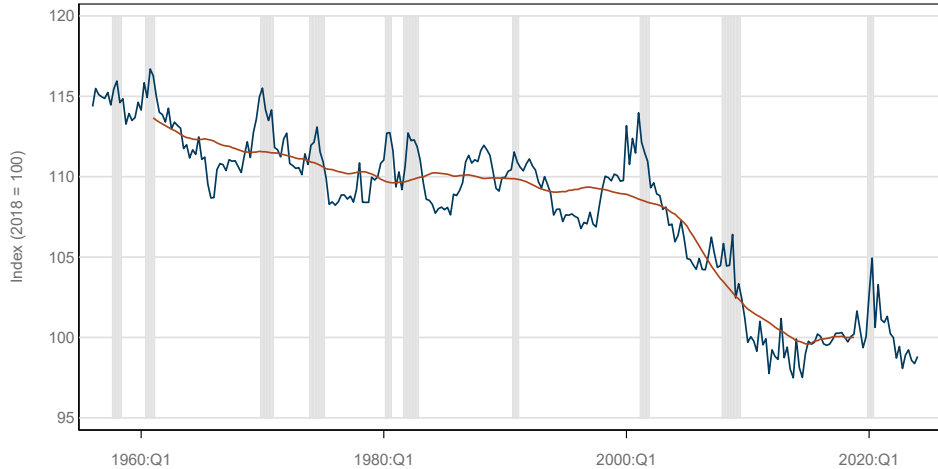
## It's about wages, productivity, and markups

Garga, V., G. P. Olivei, and J. C. Wang, *Current Policy Perspectives*, 2024-5 (June 27, 2024)

- If wage growth for **new hires** remains contained, we should see a slow but steady return of overall wage inflation to its pre-pandemic level.
- Would this moderation be sufficient to return inflation back to target?
- It depends on both markups and productivity.

# Labor share

## Business sector



Source: Haver Analytics / Bureau of Labor Statistics

# Implications

- Currently elevated markups provide firms with room to absorb higher expected labor costs without putting upward pressure on prices.
  - ▶ Provided that firms are willing to return their markups to pre-pandemic levels – a more likely scenario as the demand moderates.
  - ▶ Even if labor productivity growth reverts back to its pre-pandemic pace!
  - ▶ Implied adjustment process:
    - ▶ business-sector price inflation runs slightly above 2% in the near term
    - ▶ wages grow above 3%
    - ▶ labor share gradually returns to its 2018 level
- More favorable productivity developments going forward would support the delay in markup adjustments, helping to further dampen inflation pressures.



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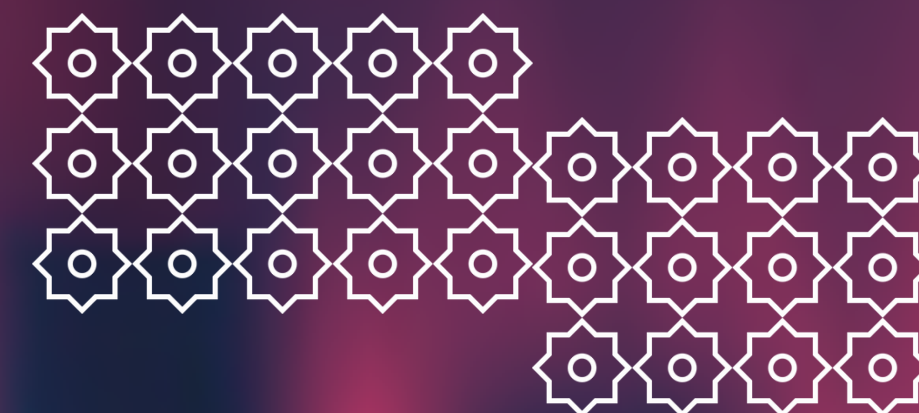
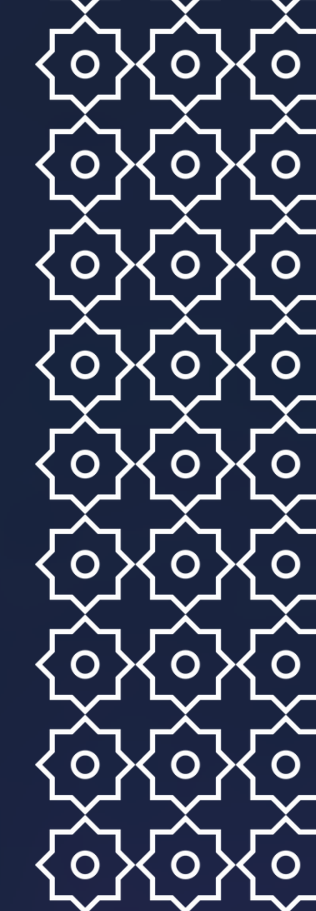


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# Inflation and Financial Markets

Prof. Ana Beatriz Galvao

Bloomberg Economics, CEPR

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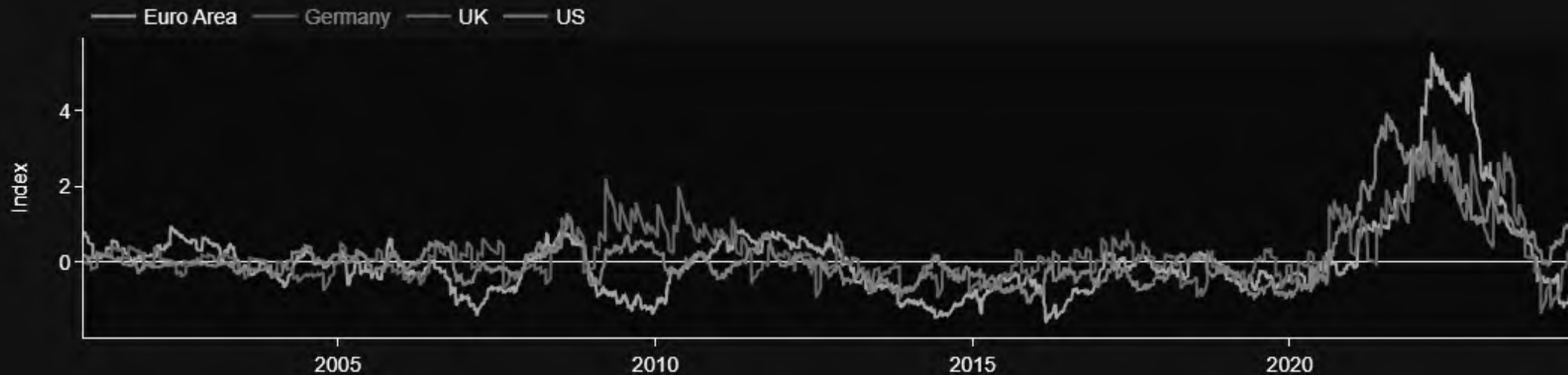


# Surprises from Inflation Data

- Surprise = actual – consensus (ECO survey median).
- Prices and wages data events with a crowd of economists giving their views in advance:
  - US: 33 data events.
  - UK: 14 data events.
  - Euro area: 44 data events (EA, Germany, France, Italy, Spain; many P/F estimates).
- Surprise indexes: what market participants have learned from data releases in the last months.

# Daily Surprise Indexes

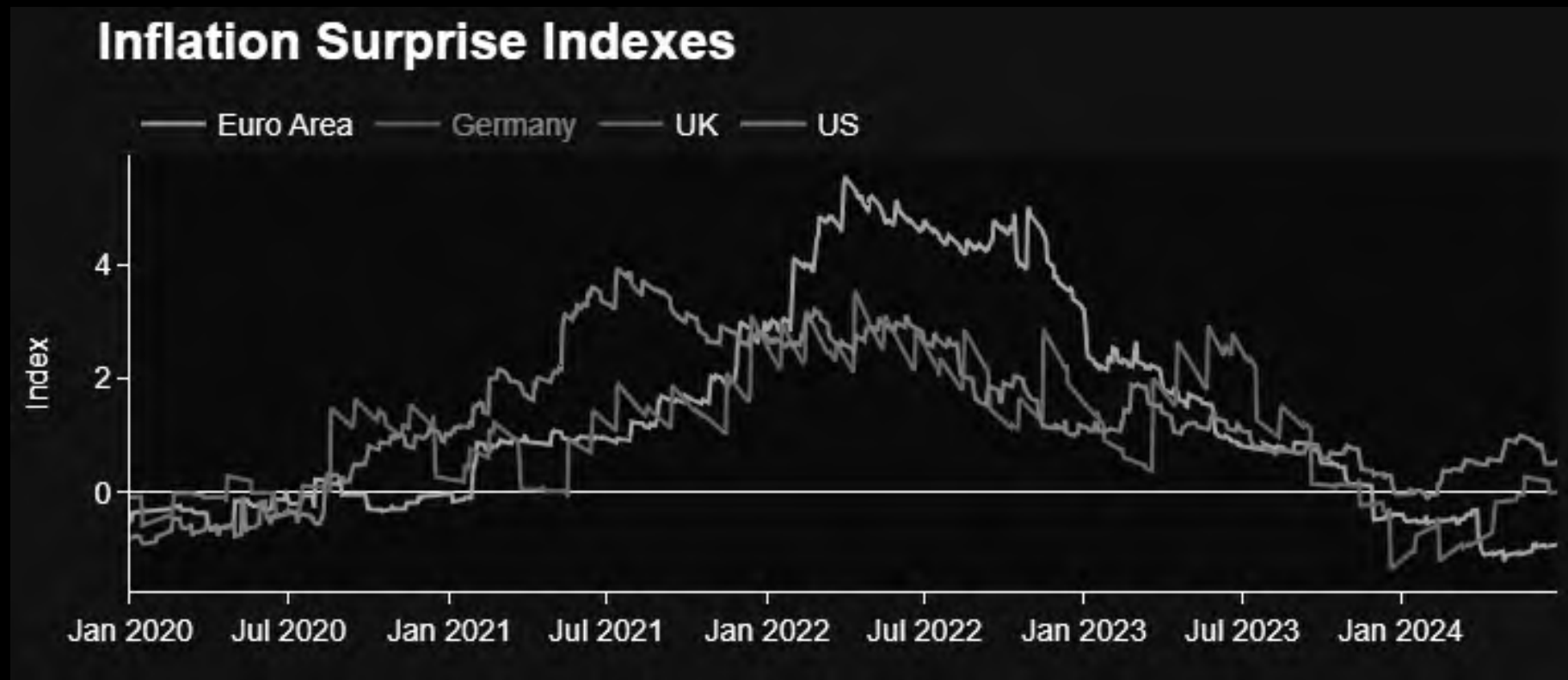
## Inflation Surprise Indexes



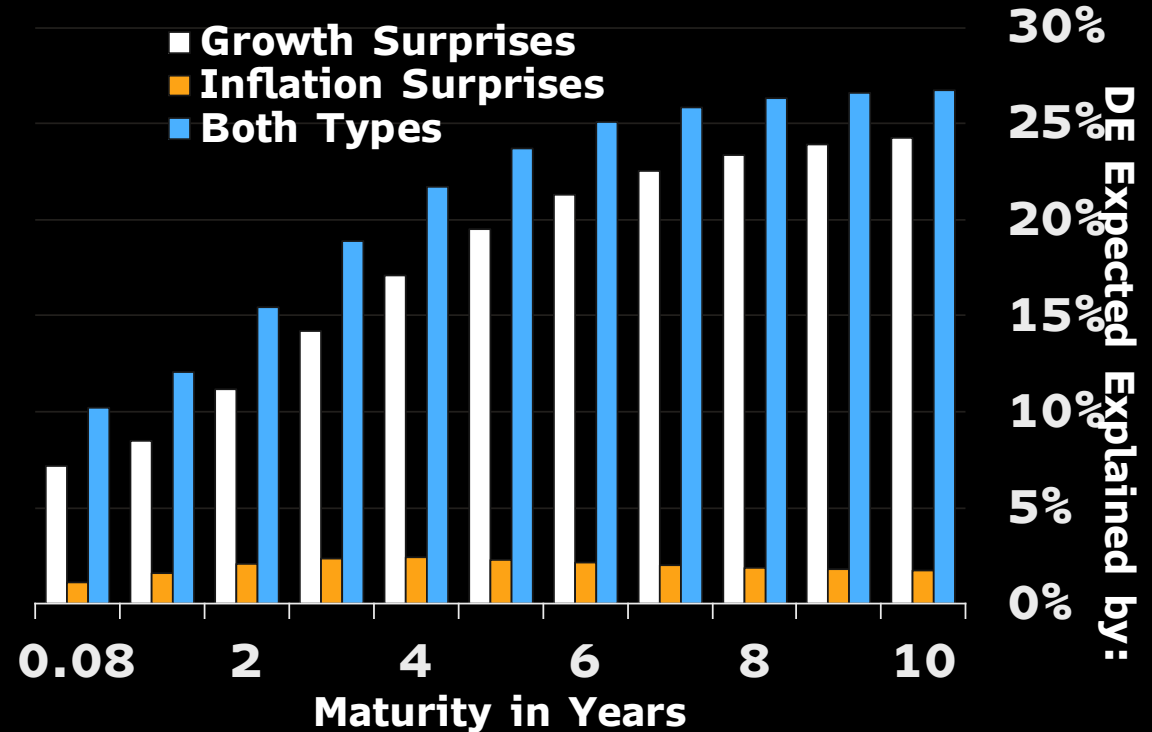
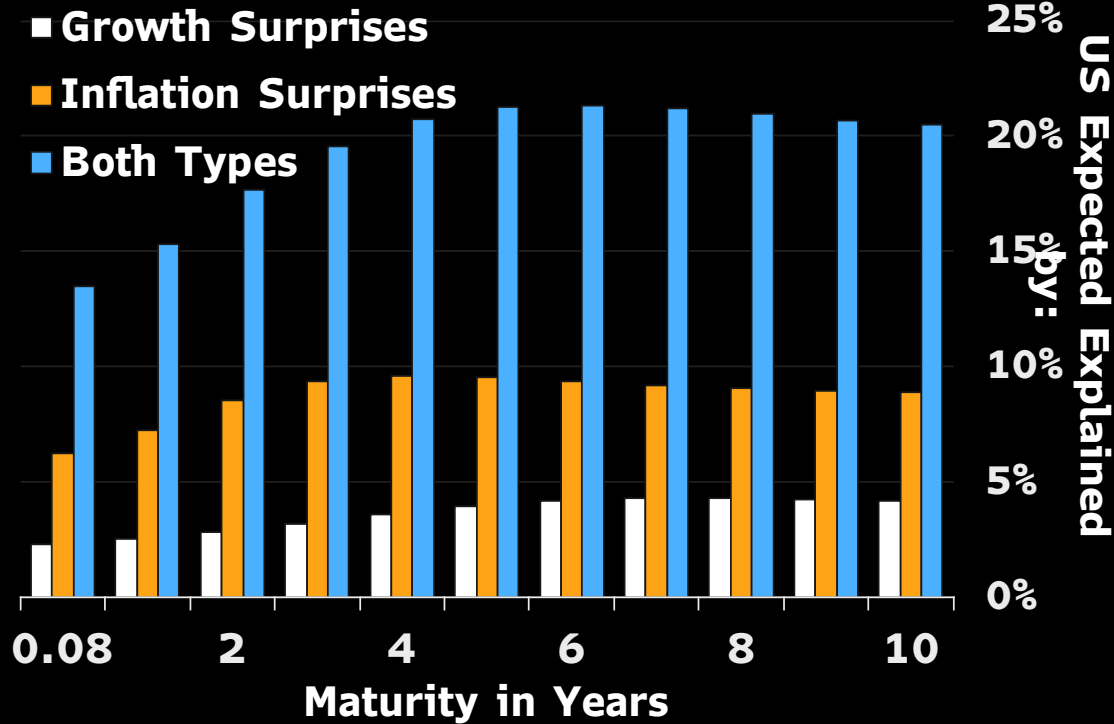
See Bloomberg Economics's Growth & Inflation Surprise Indexes on the Terminal: BCMPUSGR Index, BCMPUSIF Index, BCMPGBGR Index, BCMPGBIF Index, BCMPEAGR Index, BCMPEAIF Index, BCMPDEGR Index, BCMPDEIF Index.

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# Recent Period

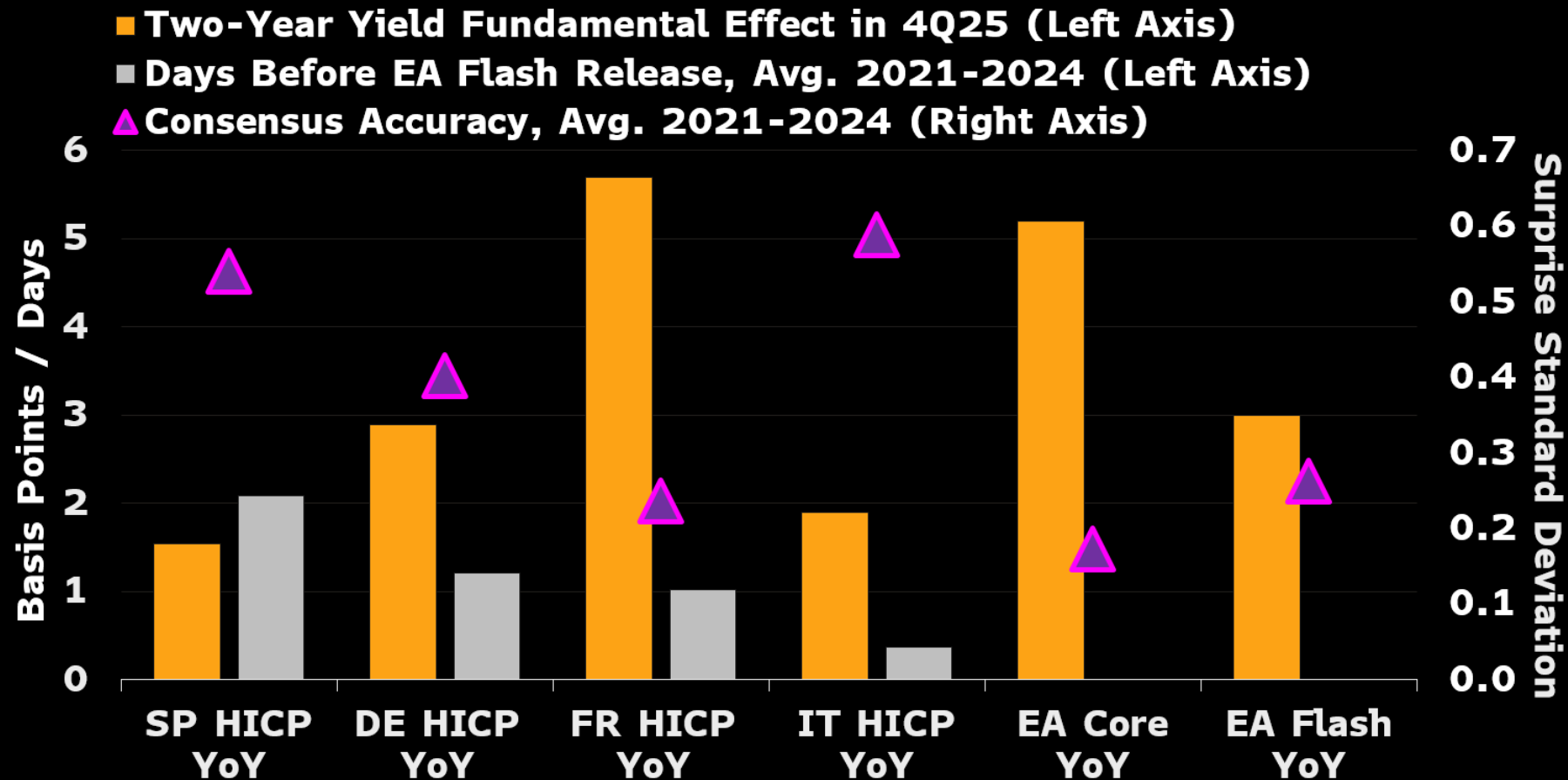


# Contribution of Inflation Surprises to Bond Yields:

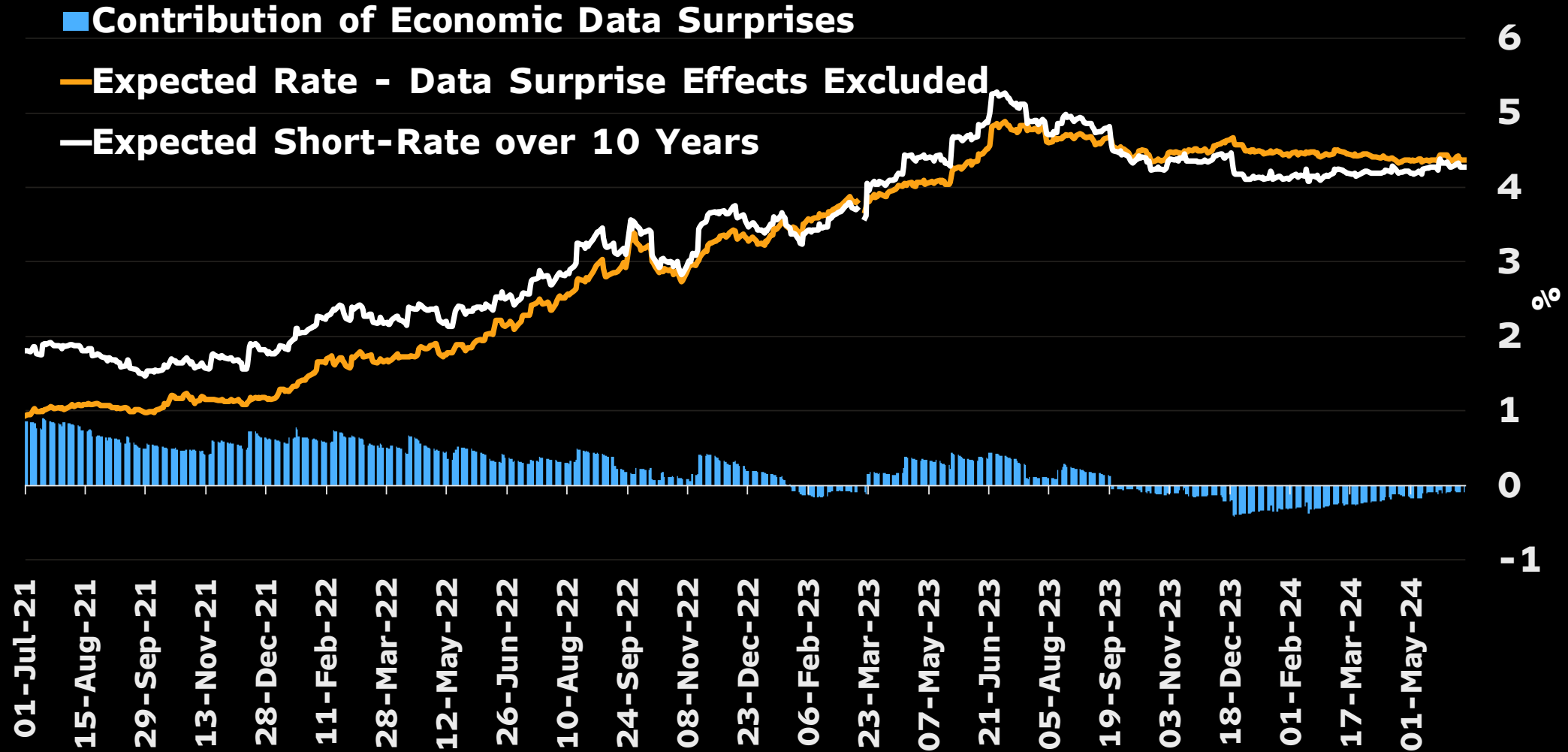


- Based on an Affine Term-Structure Model that includes growth and inflation surprise indexes as predictors of yield factors.
- Average contribution over 2001-2024.

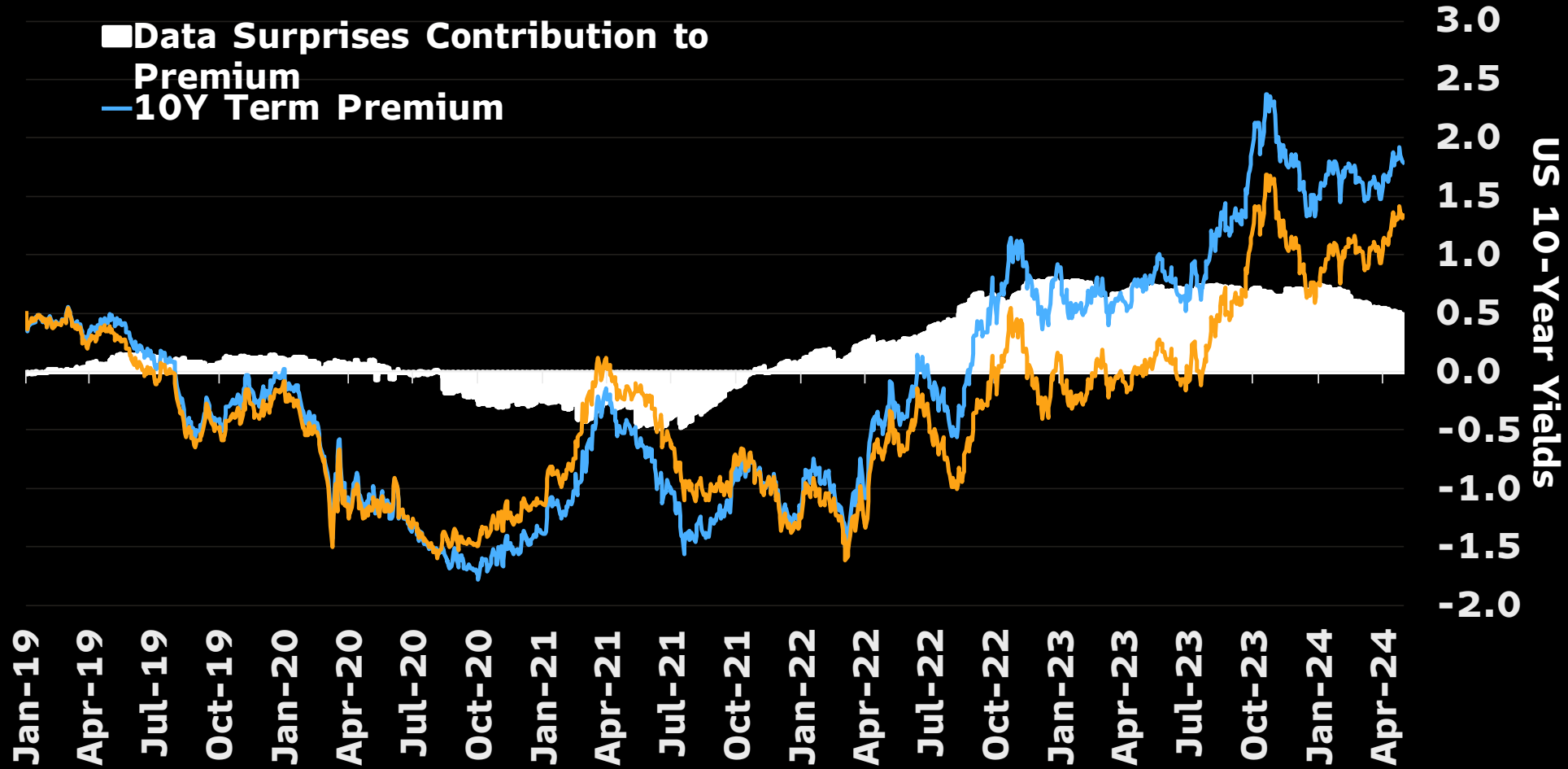
# EA Inflation Data Effects on the Risk-Free Rate



# Surprises Contribution to UK 10 Y Risk-Free Rate

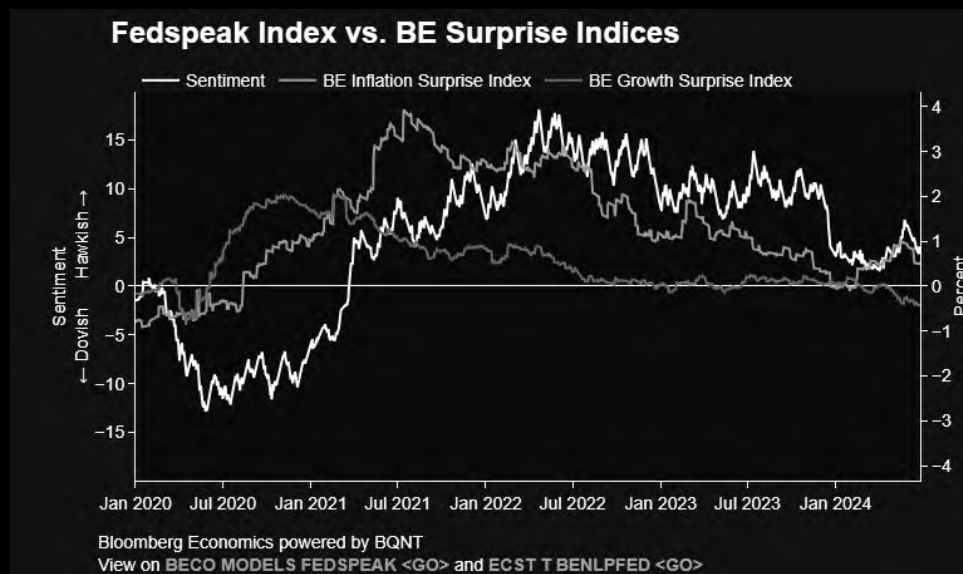


# Surprises Contribution to US 10 Y Premium



# Inflation and Financial Markets

- As monetary policy matters for financial markets, news from inflation data releases will affect bond pricing/risk premia.
- When considering exchange rates, US inflation surprises lead to Yen/US\$ depreciation.
- Inflation news may also affect markets via Fed officials' speeches/interviews, which may be market-moving.







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