Seminar: Current Topics in Macroeconomics (WS 2032-24)
Prof. Helge Berger, IMF and FU Berlin

The seminar will discuss the sources of the recent bout of inflation in the world's main advanced economies and the role that macroeconomic policies play in bringing inflation back to target. Particular attention will be paid to central banks, the use and effects of monetary policy, the interaction of monetary policy with fiscal policy, and the discussion about whether the "inflation targeting" framework might need an update.

Literature: The below listed papers and books are to get you started on your topics. You are expected to broaden this reading list on your own as you prepare for the presentation and seminar paper.

Topic assignments: Depending on demand, select topics will be assigned to more than one student.

Economic explanations of inflation

(1) **Economists' models of inflation—an overview**
Macroeconomic models relate inflation to measures of real activity such as unemployment or the output gap and inflation expectations. But the current episode also points to other important factors, including the trajectory of energy and food price shocks as an exogenous driver of inflation and the "catch-up" of nominal wage growth after the erosion of real incomes by past price increases that could make inflation more persistent going forward. What does this all mean for the factors behind the recent bout of inflation in the U.S. and euro area and what it will take to overcome it?
Literature: Hazell et al. (2022), "The slope of the Phillips Curve: evidence from US states;" Wellmann (2023), "The Phillips curve in the euro area;" Hopper et al (2020), "Prospects for inflation in a high pressure economy: Is the Phillips curve dead or is it just hibernating?"; Reis (2021), "Losing the Inflation Anchor;" Ari et al (2023), "One Hundred Inflation Shocks: Seven Stylized Facts;"Guerrieri et al. (2021), "Monetary Policy in Times of Structural Reallocation;" as well as standard textbooks (e.g., Gali; Walsh) and the literature under topic (2).

(2) **The forces behind the inflation shock—the view at the ECB and the FED**
What are the economic concepts ECB and FED policymakers and economist use most to explain the surge in inflation? Did they initially see the increase as temporary phenomenon caused by the pandemic and Russia's war in Ukraine or as something more lasting? Did they think both demand and supply factors are at work, and has that analysis shifted over time? What are the commonalities and differences in the arguments put forward by each central bank?
Literature: Central bank governor speeches and publications/reports (e.g., ECB Economic Bulletin; FED Monetary Policy Report); IMF World Economic Outlook October 2022/April 2023/October 2023 (forthcoming), Chapters 1; IMF World Economic Outlook October 2021, Chapter 2; Alberto Cavallo (2021), "Inflation dynamics during COVID;" Bernanke & Blanchard (2023), "What caused U.S. pandemic-era inflation?" Also see topic (1).

(3) **Estimating the Phillips curve to understand inflation—where do we stand?**
There has been a spirited debate about whether the relationship between real activity and inflation is linear or whether, for example, a further drop in unemployment pushes inflation up more when the economy is already overheating. What are the key problems with which researchers have to deal with when estimating the Phillips curve? What is the state of the discussion and what does it mean for the explanation of current inflation dynamics and monetary policy?

Literature: See topics (1) and (2), as well as: McLeay and Tenreyo (2020), "Optimal Inflation and the Identification of the Phillips Curve;" Hazell et al (2022), "The slope of the Phillips curve: evidence from U.S. states;" Wellmann (2023), "The Phillips curve in the euro area."

(4) **The "labor market tightness" puzzle—why are unemployment rates in the U.S. and euro area still at record lows despite high central bank policy rates?**
The current phase of very tight monetary policy does not seem to play out as the textbooks suggest—instead of rapidly cooling labor markets, unemployment rates are at secular lows in the world's main economies. What is behind this? Which of the many explanations given—from slower-than-usual transmission of higher interest rates to the real economy, the repercussions of the lifting of COVID restrictions, or the continuation of long-running demographic trends—is the most probable?
Literature: Pizzinelli (2022), "The Puzzling Labor Market" (podcast); Domash and Summers (2022), "A Labor Market View on the Risk of a US Hard Landing;" Duval et al (2022), "Labor Market Tightness in Advanced Economies;"and the running commentary in the periodic IMF (*World Economic Outlook*) and OECD (*Economic Outlook*—e.g., in June 2023) global outlook publications.

(5) **Monetary policy transmission—what do economists and central bankers say about how monetary policy is affecting inflation?**
The debate about how monetary policy is affecting the economy and inflation is among the oldest in modern macroeconomics, but the recent bout of inflation has brought it back to the frontlines. What matters most: interest rates, bank credit, "quantitative tightening," central bank communication, or all of the above? What might we be missing? What does it mean for the conduct of monetary policy?
Literature: Any standard textbook (e.g., Gali; Walsh); Darracq-Paries et al (2023), "A model-based assessment of the macroeconomic impact of the ECB's monetary policy tightening since December 2021;" Lane (2023), "The bank lending channel of monetary policy;" Battistini et al (2023), "Monetary policy and housing investment in the euro area and the U.S.;" Bandera et al (2023), Monetary policy in the face of supply shocks: the role of expectations;" Ari et al (2023), "One Hundred Inflation Shocks: Seven Stylized Facts;"Central bank governor speeches and publications/reports (e.g., ECB Economic Bulletin; FED Monetary Policy Report); IMF (forthcoming), Chapters 1 and 2 of the Word Economic Outlook October.

(6) **Do "independent and credible" central banks have an easier time controlling inflation?**
What is the theoretical case for making central banks independent of elected politicians and charge them with keeping inflation low even at the cost of (at times) higher unemployment and lower growth? What does the empirical track recorded show—does credible independence of central banks help contain inflation? If there is a lack of credibility, how can it be earned? What are the implications for the euro area, U.S., and Japan?
Literature: Elgin et al. (2021), "Economic policy responses to the COVID-19 pandemic: The role of central bank independence;" Vonessen et al. (2020), "The Case for Central Bank Independence: A Review of Key Issues in the International Debate;" Bordo & Siklos (2015), "Central Bank Credibility;" De Haan et al. (2018), "Central Bank Independence Before and After the Crisis."

(7) **What role does fiscal policy play for inflation?**
If central banks raise rates to bring inflation back down to target, should fiscal policy help? If fiscal policy ought to help, can it actually make a difference given its slow-moving nature? And how is the track record of fiscal policy in this regard? The significant increase in sovereign debt triggered by the pandemic at a time of very expansionary monetary policy in many economies has revived the discussion of fiscal policy forcing the hand of central banks and, ultimately, triggering inflation—is

this a valid concern? What are the arguments and what does the evidence say?
Literature: 2021 Jackson Hole Symposium Panel on "The Interaction of Monetary and Fiscal Policy;" Leeper & Leith (2017), "Understanding Inflation as a Joint Monetary-Fiscal Phenomenon;" Barthelemy et al. (2021, "Large public debts need not imply fiscal dominance;" Chada et al. (2021), "Monetary and Fiscal Complementarity in the Covid-19 Pandemic;" Jorda & Nechio (2023), "Inflation and wage growth since the pandemic."

(8) **Has the pandemic permanently scarred the global economy, adding to higher inflation?**
What are the effects on labor—has human capital been affected and will these effects last? Employees have retired or moved away contact-intensive sectors—will this last? Are we still over-estimating potential output, as some academics have argued policymakers have done in the past, leading to economies running "hot" and driving up inflation?
Literature: Duval et al. (2022), Labor Market Tightness in Advanced Economies; Faberman et al. (2022), "Has the Willingness to Work Fallen During the Covid Pandemic?; Crump et al. (2022), "The Unemployment-Inflation Trade-off Revisited: The Phillips Curve in COVID Times"; Le Roux (2022), "How persistent supply chain disruptions could affect euro area potential output;" Orphanides (2002), "Monetary-Policy Rules and the Great Inflation;" Fernald and Li (2021), "The impact of COVID on Potential Output;"

(9) **"Economic fragmentation"—what are the forces at work, and could they add to inflation?**
Policymakers are voicing concerns about national and economic security, reflecting the interruptions of global supply chains during the pandemic and increasing geopolitical tensions. There are calls to "friend-shore" supply chains and restrict access to critical technologies by countries seen as foes. What are the possible effects of fragmentation on growth, productivity and inflation?
Literature: Attinasi & Balatti (2021), "Globalization and its implications for inflation an advanced economies;" Cerdeiro et al (2021), Sizing up the effects of technological decoupling; Bateman (2022), Biden is now all-in on taking out China; IMF (2022), Global Trade and Value Chains in the Pandemic; IMF (2022), Asia and the Growing Risk of Geo-Economic Fragmentation (chapter 2 in Regional Economic Outlook for Asia and Pacific, October 2022); Aiyar et al (2023), "Geoeconomic Fragmentation and the Future of Multilateralism."

(10) **Costs of inflation and inflation targets—why is inflation a concern and what does it mean for monetary policy?**
Just how much inflation if too much? Hyperinflation is obviously too high, but is zero inflation too low? Where is the optimal rate of inflation that central banks should target, and should the goal vary across countries and circumstance. What is good time to adjust an inflation goal? These are crucial questions that the profession has discussed for long. The topic will revisit the most important arguments in this important debate and lay out the implications for central banks seeking to cool inflation at the current juncture.
Literature: Driffill et al (1990), "Costs of inflation;" Dotsey & Ireland (1996), "The welfare costs of inflation in general equilibrium;" Nakamura et al; (2018), "The elusive costs of inflation: price dispersion during the U.S. Great Inflation;" Schmitt-Grohe & Uribe, (2011), "The optimal rate of inflation;" Krugman (2014), "Inflation targets reconsidered;" Ari et al (2023), "One Hundred Inflation Shocks: Seven Stylized Facts."

(11) **Potential output—what does it do to inflation and how to measure it?**
Most economists think inflation co-moves with the level of economic activity relative to some measure of the economy's overall capacity—aka, "potential output"—a concept that can be underpinned by various economic models. In practice, potential output can not be observed but

must be estimated. This task, however, has turned out to be more complex than central bankers would like. What are some of the approaches used in the field and how do they perform? *Literature*: Guisinger et al. (2018), "Comparing Measures of Potential Output;" Toth (2021), "A Multivariate Unobserved Components Model to Estimate Potential Output in the Euro Area: A Production Function Based Approach;" Dowling et al. (2015), "Steady as She Goes—Estimating Potential Output During Financial Booms and Busts;" Orphanides (2002), "Monetary-Policy Rules and the Great Inflation;" Smets (2002), "Output gap uncertainty: Does it matter for the Taylor rule?"