NY Fed Economic Advisory Panel Meeting
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INFLATION AND THE US AND GLOBAL ECONOMIC OUTLOOK

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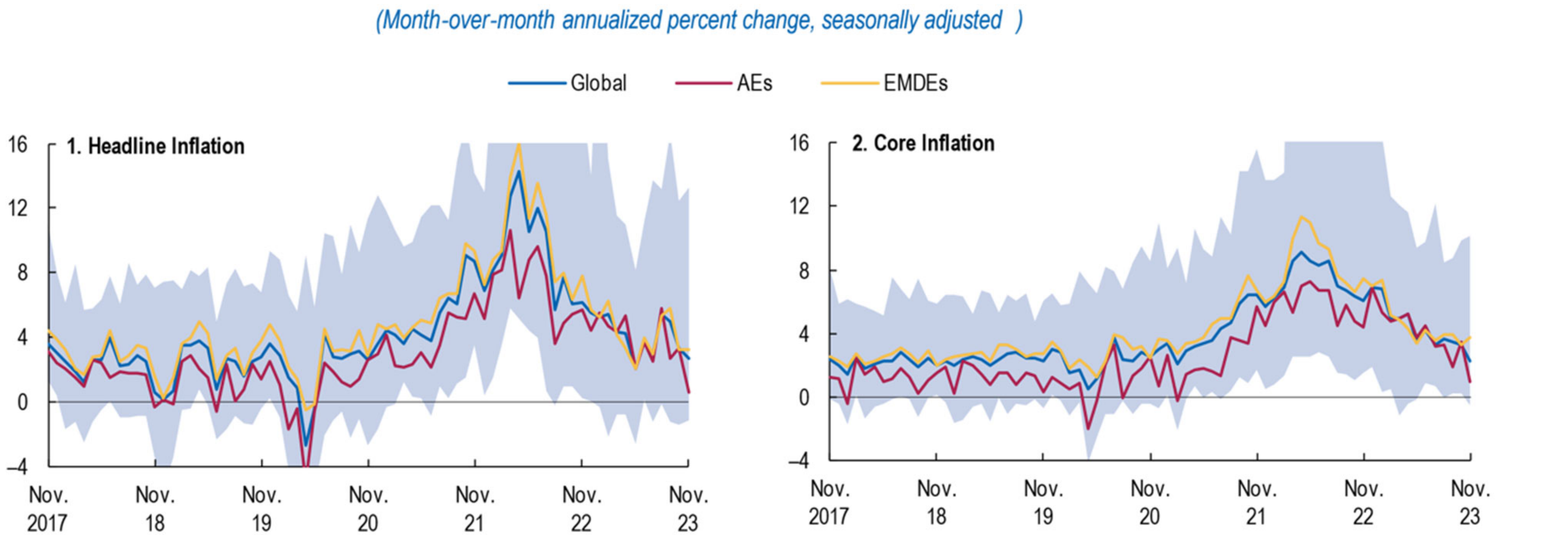
GLOBAL DISINFLATION (IMF WEO, JAN 2024)

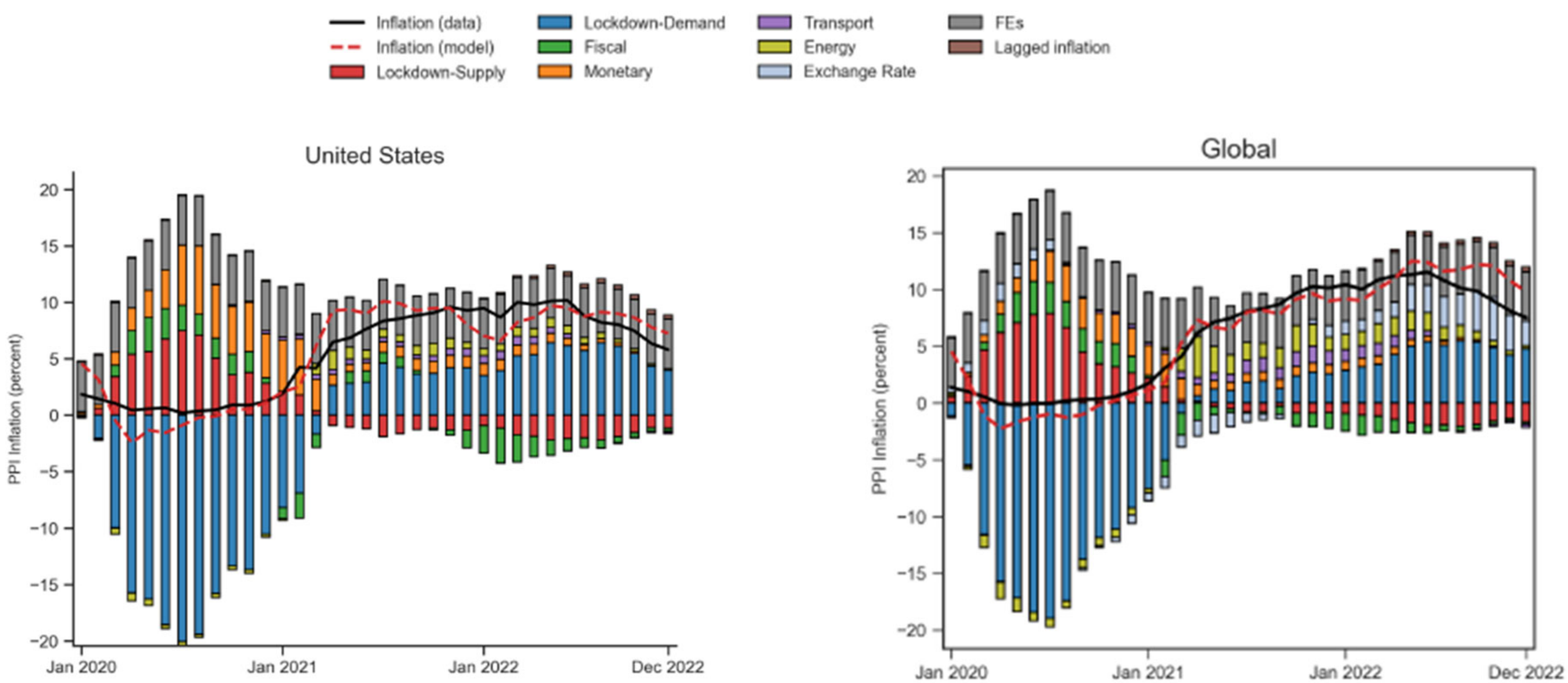


Sources: Haver Analytics; and IMF staff calculations. Note: The figure plots the median of a sample of 57 economies that accounts for 78 percent of World Economic Outlook world GDP (in weighted purchasing-power parity terms) in 2023. Vertical axes are cut off at –4 percent and 16 percent. The bands depict the 10th to 90th percentiles of inflation across economies. "Core inflation" is the percent change in the consumer price index for goods and services, excluding food and energy (or the closest available measure). AEs = advanced economies; EMDEs = emerging market and developing economies

STEPPING BACK: RECENT DRIVERS OF INFLATION

- **Pre-pandemic:** tight labor market did not lead to increases in inflation
  - Explanations:
    - Globalization: local labor markets no longer relevant
    - Decline in Unions: weaker worker bargaining power
    - Central Bank credibility: 2% inflation expectations anchored
    - Low unemployment overstates labor market tightness
    - Higher price transparency (online shopping platforms)
- **Pandemic:** initially (mostly) supply shocks, later demand shocks, drive up inflation
  - Explanations:
    - Global supply chain disruptions and goods/services demand reconfigurations
    - Impacts of changes in labor force participation
    - Demand for work-from-home, cost-of-living adjustments, union organizing

DRIVERS OF INFLATION: LOCKDOWN REOPENING



Source: Chau, V., Conesa Martinez, M., Kim, T., & Spray, J. (2024). Global Value Chains and Inflation Dynamics. *IMF Working Papers, 2024/62, Figures 4 and 5.*

LINGERING QUESTIONS

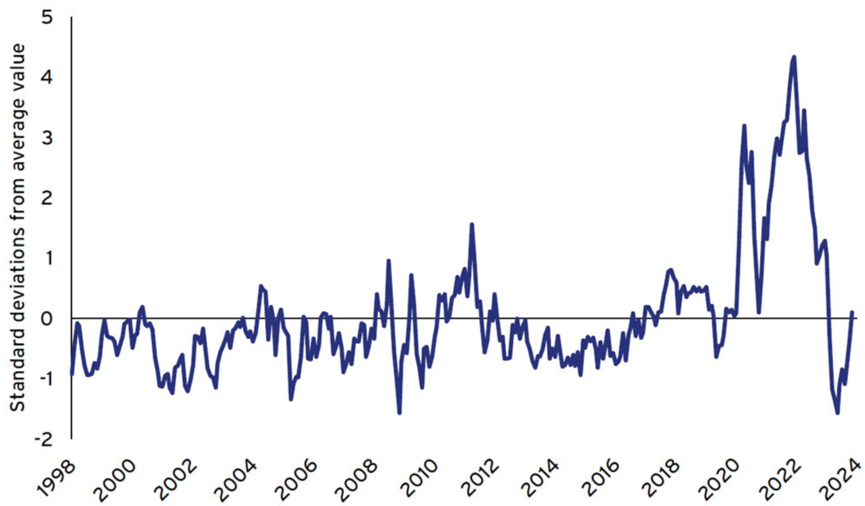
- Did inflation expectation errors play a role?
  - Most model-based inflation forecasts (starting at 2020) significantly under predicted actual inflation in 2021-2023.
  - Did overly optimistic forecasts for inflation (rather than lack of preemption) delay tightening?
- How much did labor costs drive inflation?
  - Recent papers suggest a small effect (so far).
- Can we learn anything from international inflation comparisons?
  - Clearer role for goods/commodity price shocks outside of US.
- Is US unemployment unnaturally low?
  - Estimates of U* range from 4 percent to 7 percent, above the current unemployment

DRIVERS OF DISINFLATION

- Unwinding of pandemic-era disruptions
- Monetary policy shifts and quantitative tightening
- Relative import prices
- Expectations of reduced tightness in labor market conditions

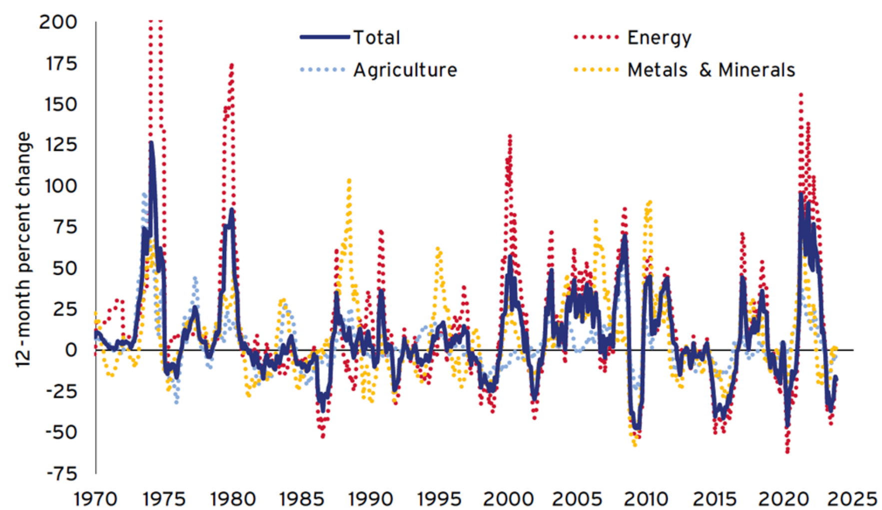
UNWINDING OF PANDEMIC DISRUPTIONS

Global Supply Chain Pressure Index



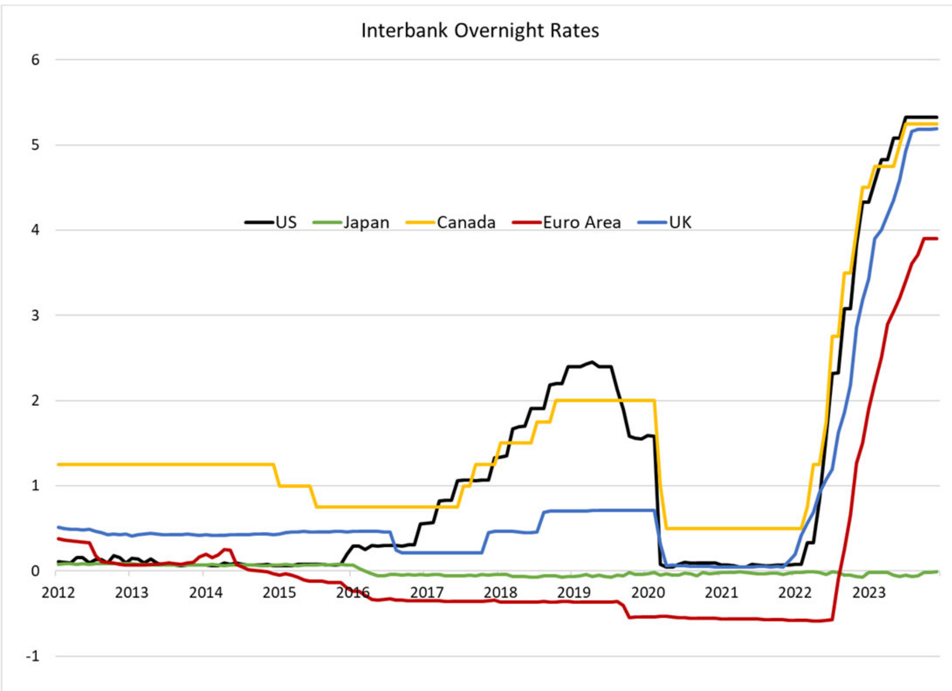
Source: Data from Federal Reserve Bank of New York.

Commodity Price Inflation

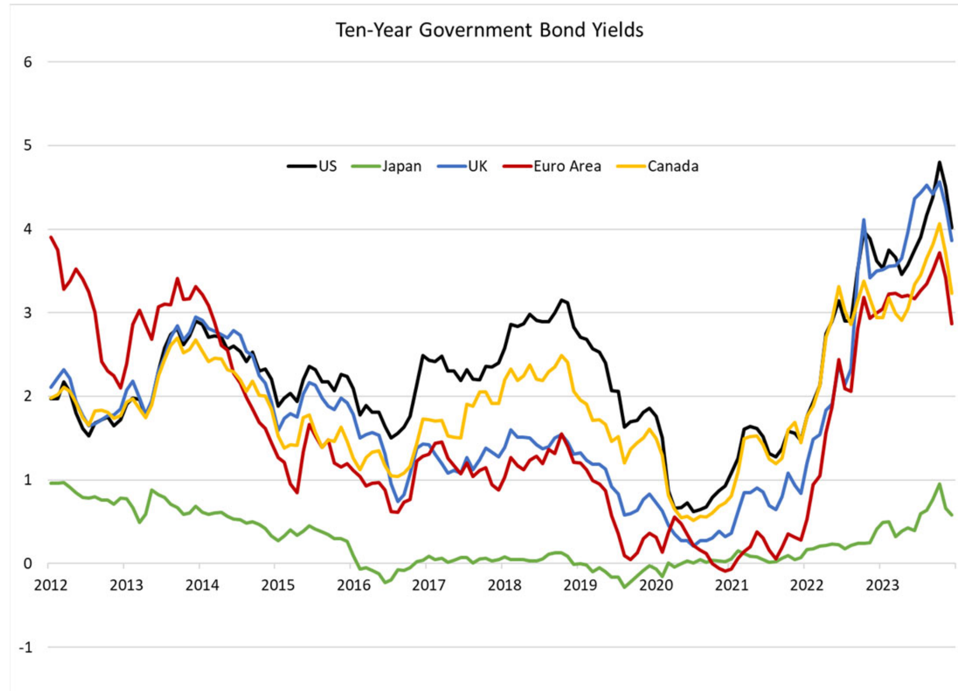


Source: Data from World Bank.

GLOBAL INTEREST RATE SHIFTS

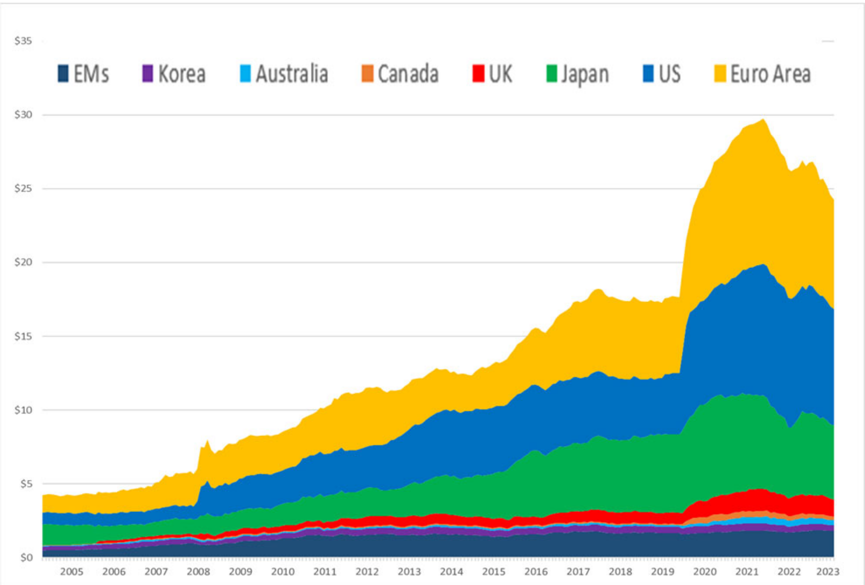


Source: FRED, US rate is Federal Funds Effective Rate

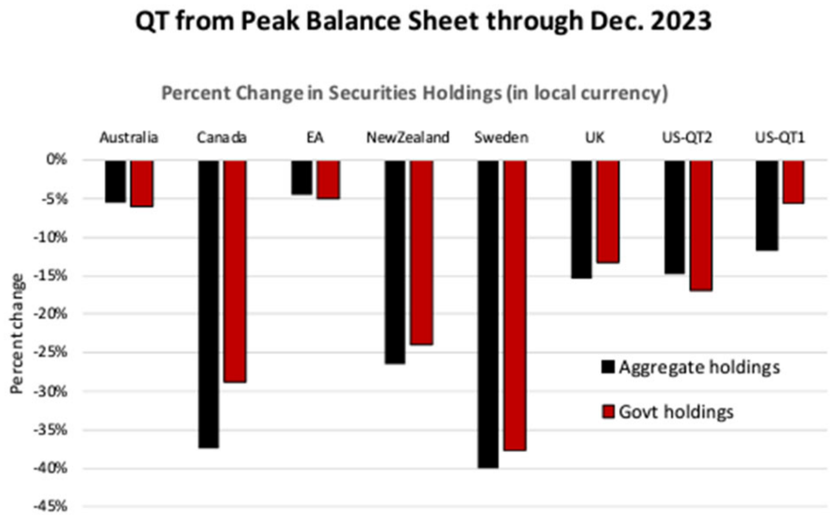


Source: FRED, 10-year benchmark rates

QUANTITATIVE TIGHTENING



Source: Dominguez and Foschi (2024), "Whatever-It-Takes Policymaking during the Pandemic," NBER WP 32115.



Source: Du, Forbes and Luzzetti (2024), "Quantitative Tightening Around the Globe: What Have We Learned?," US Monetary Forum

SPILLOVER/SPILLBACK* EFFECTS OF TIGHTENING

Prosper-thy-neighbor: tighter monetary policy and financial conditions may lead to

- expenditure switching: appreciation of the home currency, potentially shifting demand to foreign goods

Beggar-thy-neighbor: tighter MP reduces AD, induces portfolio rebalancing, increases foreign inflation

- expenditure changing: reduced demand for all goods (including foreign goods)
- capital flows: higher domestic interest rates may lead investors to rebalance portfolios from foreign to domestic assets, tightening foreign financial conditions
- exchange rates: foreign country currency depreciation tends to increase foreign inflation

Caveats

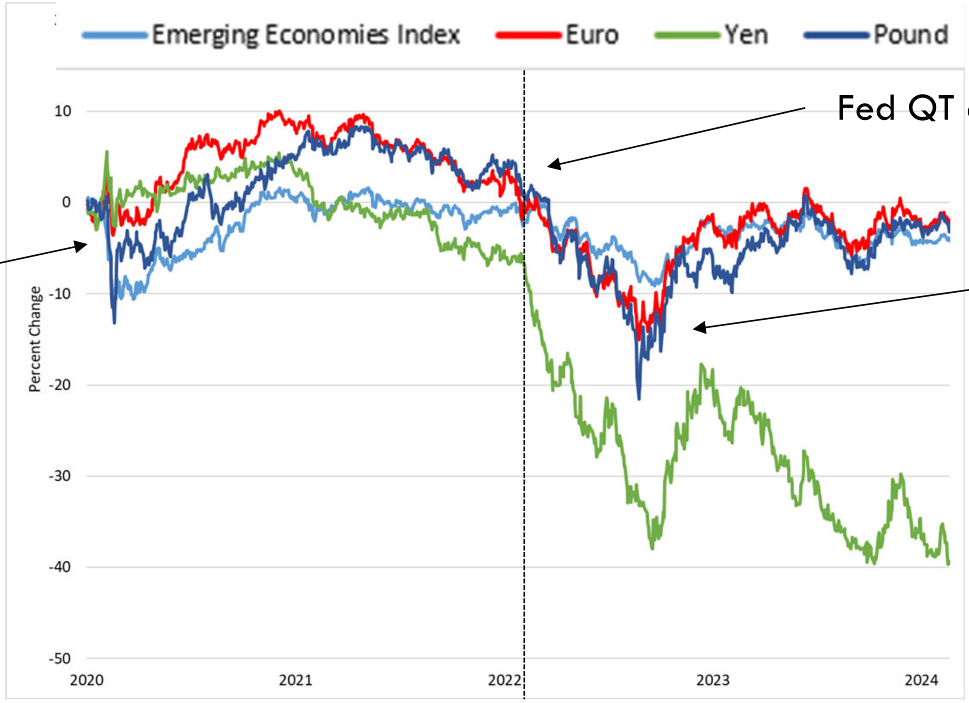
- Global simultaneous monetary tightening should result in fewer spillovers
- Spillbacks will depend on relative policy actions

*Acharya and Pesenti (2024) define "monetary policy spillbacks as the effect of a change in the domestic policy stance on domestic output in excess of the effect that would arise if the economy were closed to international trade in goods and assets." (page 1)

CURRENCY VALUES AGAINST USD

Fed QT announcement

Multi-country whatever-it-takes QE announcements

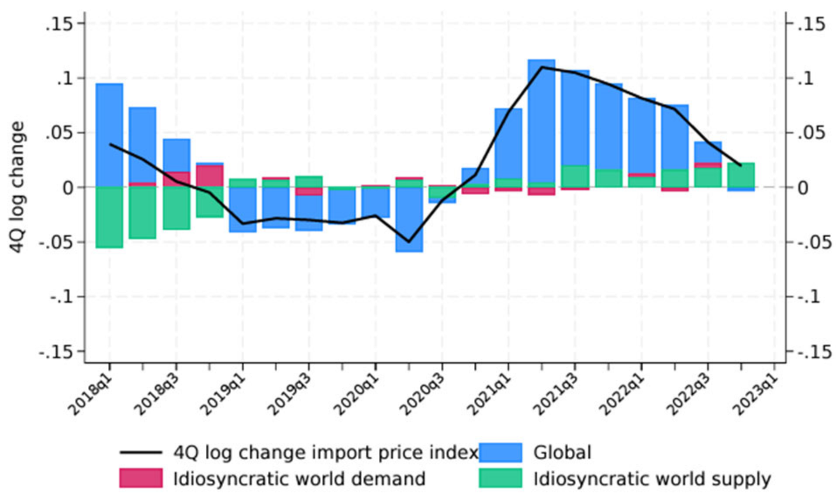


Markets expect Fed easing and forecasts of global growth in 2024 improve

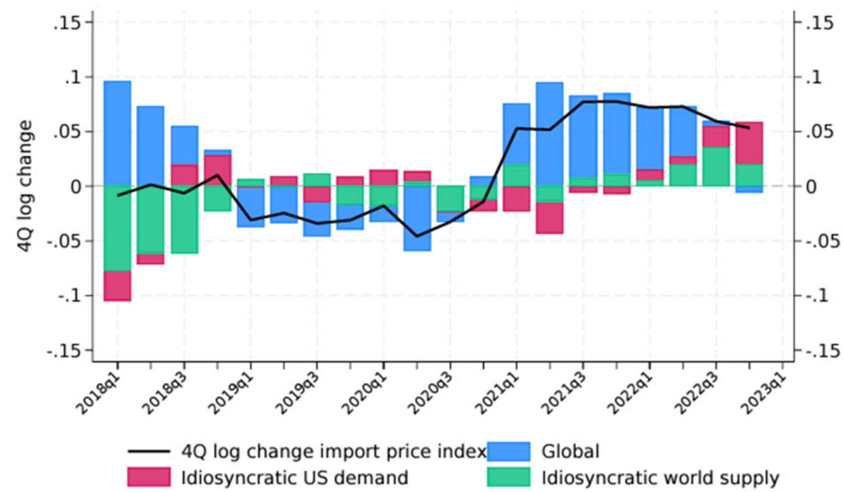
Source: Federal Reserve Bank of St Louis, (FRED data).

US IMPORT PRICE INFLATION: REMAINING HIGH…

Drivers of World Export Price Growth

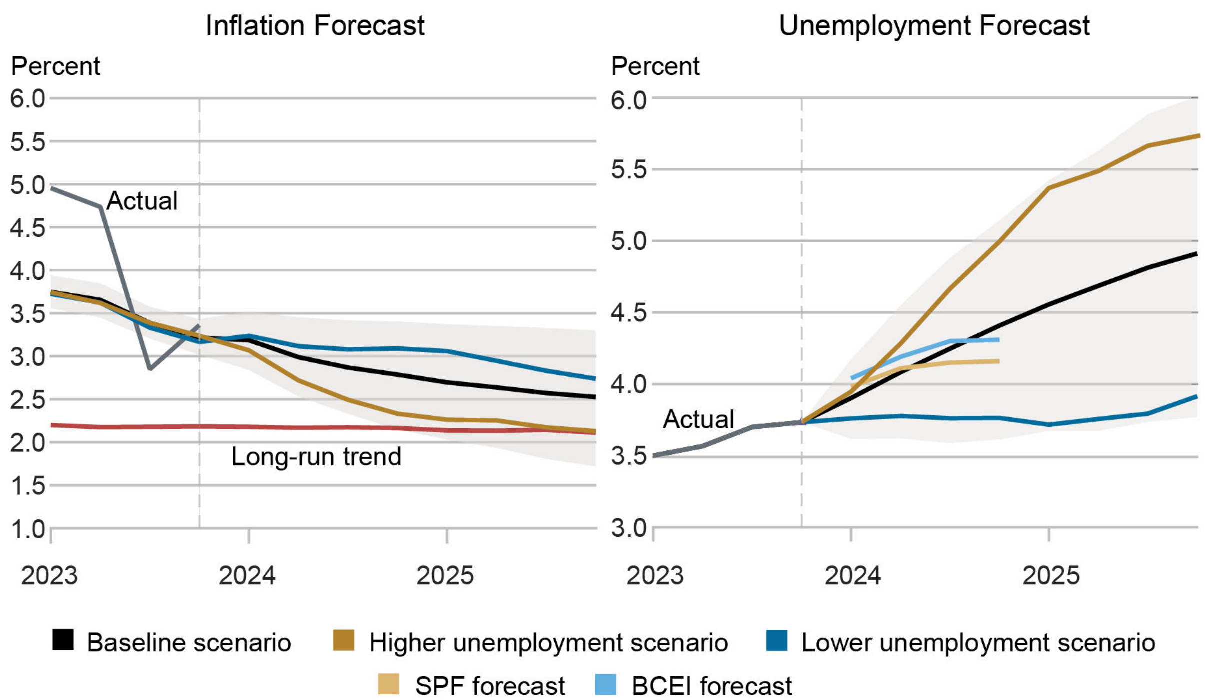


Drivers of US Import Price Growth



Source: Amiti, M, Itskhoki, O and D. Weinstein, "What Drives U.S. Import Price Inflation? NBER WP 32133, Feb 2024.

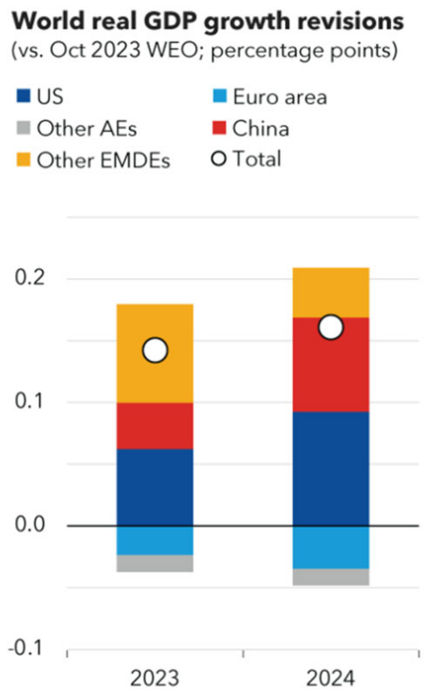
LABOR MARKET EXPECTATIONS: COOLING



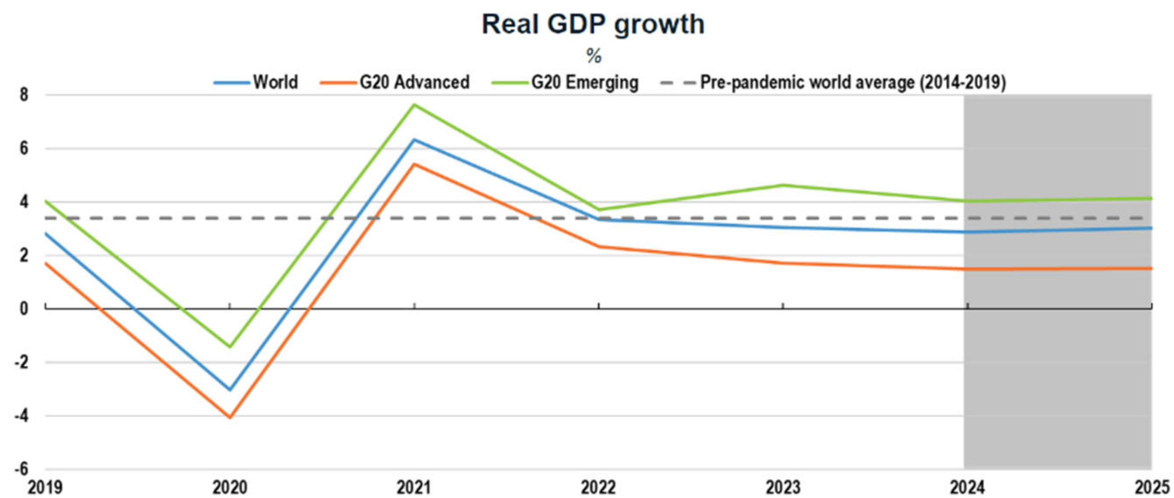
Model forecast: speed of disinflation depends on expected path of unemployment

Source: Crump, R., Eusepi, S, and Sahin, A., "Expectations and the Final Mile of Disinflation." Liberty Street Economics, March 5, 2024

IMPLICATIONS FOR GROWTH: GLOBAL SOFT-LANDING



Sources: IMF, World Economic Outlook; and IMF staff calculations.



Note: Shaded area refers to OECD projections.
Source: OECD Interim Economic Outlook 115 database; and OECD calculations.

RISKS FROM ABROAD

- Conflicts: Middle East, Russia against Ukraine (impacts on energy markets and shipping)
- China's economic slowdown and debt problems
- Potential contagion from financial market stress as global interest rates remain high
  - concerns about EMs with elevated debt levels
  - March 2023 banking turmoil redux
- Ongoing risks of cybersecurity threats and data breaches
- (Further) trade fragmentation