A Diligent Return to Price Stability

Loretta Mester
Cleveland Fed

10. Nov. 2022
Overview

- “Mester Presentation”

1. Inflation anchor: Wobbly?
2. Labor tightness vs. GDP output gap
3. Monetary Policy: real interest, QT, FAIT
4. Fiscal-Monetary Interaction
5. International impact of US MoPo
1. An inflation anchor breaks
   a. Smoothly/continuously
   b. Discontinuously

2. Labor market tightness is due to
   a. Temporary labor productivity shock
   b. Permanent labor productivity shock
   c. Change in workers’ preferences

3. Desired to return to
   1. 2% inflation target
   2. Flexible average inflation target
   3. Higher inflation target

4. Inflation Reduction Act will lower inflation
   a. Yes
   b. No
A Diligent Return to Price Stability
Inflation Anchor: Wobbly or not?

- When lost, then it’s too late?
  - Threshold or continuous?

- Indicators:
  - Core is better predictor of inflation, 
    ... but non-core better about anchor

- Whose expectations?
  - Bond traders: 5y5y, infer tail risks from options
  - Households: survey
  - Firms: survey and pricing power
Tightness: Labor Market vs. GDP

- What to focus on? Output gap
- Labor market tight, but GDP less so
  - Price-wage spiral? Wage compression
  - Labor productivity decline?
- Change in workers’ preferences?
  - WfH
    - Good for welfare, bad for GDP
    - Learning to adjust work processes (temporary phenomenon)
- Is “White-collar recession” different?
- Labor supply will increase again as income effects from stimulus will fade?
Monetary Policy

- Increase in real interest rate (Taylor Principle)
  - At what maturity
  - Interaction btw action and communication
  - Lag of MoPo and persistence of rate rise
- QT
- Return to what regime?
  - Average Inflation Targeting
    - Asymmetric or not?
    - De-facto deviation from 2%
- Pre- or post-great moderation
Fiscal-Monetary Interaction

- Policy makers “MMT Thinking”
- Inflation Reduction Act

Interaction:
- Fiscal, Monetary, Financial Dominance
- Financial instability:
  - LDI’s in US?
International Impact of US MoPo

- Relative size of spillovers and spillbacks
  - Repeat of 1980s Latin America?

- Exchange Rate

- Bank of Japan
  - Yield Curve Control
  - FX intervention

- Spillbacks?