Comment on
Benigno and Faia,
“Globalization, pass-through and inflation dynamic”

by
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Summary

• Topics: How does globalization affect …
  – the exchange rate pass-through on import prices,
  – and the domestic inflation dynamics?

• Globalization defined as an increase in the share of foreign firms in the domestic market (or, in some cases, their number).
Summary, continued

• The core of the idea: Make the number of firms finite and introduce strategic interaction between the firms in price setting.

• The shares matter!
Summary, continued

• Results on pass-through
  – Even in LR, PT is increasing in the share of foreign firms.
  – Also in SR.
Summary, continued

• Results on domestic inflation, LR
  
  – Domestic price becomes a weighted average of domestic and foreign costs.

  – As the foreign share increases, foreign costs become more important.
Summary, continued

• Results on domestic inflation, SR
  – Relative share (or relative prices) augmented Phillips Curve!

\[
\pi_{h,t} = \left[ k \cdot mc_t + \alpha \cdot \text{share}_t \right] + \beta \cdot E_t \pi_{h,t+1}
\]

  – As the foreign share increases, domestic prices become less responsive to domestic costs.
Comment 1: Great topic  (at least for us…)

• Heated debate in Japan: “Has China contributed to our deflation?”

• Popular view among economists: “No. The China thing is about relative prices. It has nothing to do with the absolute price level.”

• Our heart says: “Yes, it must have!”
continued

• This paper: introduces a link between foreign costs/prices and domestic inflation via the augmented Phillips Curve.

• (Needs a certain policy rule to close the model.)
Comment 2

• The core idea seems very natural and appealing to me.

• If we want to talk about a global “competition”, we have to model the degree of competition.
  – Monopolistic competition model is not appropriate.
Comment 3

• Underlying assumption of the model = all the goods are consumer goods.

• Japan in 2009: Among all the imports, industrial supplies: 49.6%, capital equipment: 23.3%.

• How do we incorporate intermediate products (and crude materials) into this model? Would it change the results?
Comment 4

• In the SR model… foreign firms pay the “menu costs” when they change prices in the domestic currency unit.

• But in reality, prices of many traded goods are quoted in the units of foreign currencies:
Shares of major currencies in trade contracting (Dec 2008, source: Bank of Japan)

<table>
<thead>
<tr>
<th></th>
<th>US dollars</th>
<th>Euro</th>
<th>Yen</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports from Japan</td>
<td>54.7</td>
<td>12.5</td>
<td>30.3</td>
</tr>
<tr>
<td>Imports into Japan</td>
<td>70.4</td>
<td>3.0</td>
<td>24.6</td>
</tr>
</tbody>
</table>

Including imports from outside US!
• In Shioji, Vu and Takeuchi (2010):
  – Rotemberg style price adjustment costs.
  – Cost associated with changing prices in the seller’s currency units.
  – Cost associated with changing prices in the buyer’s currency units.
  – Total cost is a weighted average between the two.
Comment 5

• Multi-national firms?

• How would their presence change the model?
Comment 6

• The role of firm size more complicated in reality.
• Large firms: can pay a fixed cost to set up foreign exchange risk management centers… choice of invoicing currencies becomes less crucial.
continued

• Large firms tend to trade in US$ … a way to concentrate all the currency risks to Tokyo.

• Small firms are more interested in trading in JPY, to avoid currency risks.
Comment 7

• Why are the impacts of $N$’s and $s$’s so apparently small in the simulation?

• E.g. Figure 3 in page 37.
Comment 8

• Small questions on the empirical studies.

• Why use the *real* exchange rate? (It seems to include info on domestic prices.)

• Can we estimate industry-by-industry domestic price equations? (rather than just two sectors?)
Comment 9

- Applicable to Japan? Case of textile.
correlation between exchange rate and imported price of textile, 5 yrs window

Both series in log 12 months differences. Exchange rate = nominal effective exchange rate, BOJ
correlation between imported price and domestic price of textile, 5 yrs window

Both series in log 12 months differences.