Discussion of Benigno & Faia
“Globalization, Pass-Through and Inflation Dynamic”
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Some facts

• Phillips Curve instability
  – Declining responsiveness of inflation to domestic slack

• Pass through of exchange rate changes to domestic prices

• Divergent behavior of the prices of (traded) goods and (nontraded) services
Some facts

• Phillips Curve instability
  – Declining responsiveness of inflation to domestic slack (e.g. Roberts (2006))

• Pass through of exchange rate changes to domestic prices

• Divergent behavior of the prices of (traded) goods and (nontraded) services

• Globalization
  – Financial globalization
  – Real globalization
The contribution of this paper

• Theory
  – Globalization leads to greater pass through
  – Globalization changes the slope and position of the New Keynesian Phillips Curve (the “global slack hypothesis”)

• Empirics
  – Pass through has increased post 2001 due to globalization
  – Support for the global slack hypothesis: Importance of the relative price channel (sectoral terms of trade) in explaining US inflation dynamics
The key mechanism

- Time varying elasticity of demand:

\[ \sigma_i = \sigma - (\sigma - \theta) \xi_i \]
Main results

• Pass through

\[
\frac{\partial \hat{P}_{f,t}}{\partial S_t} = \frac{1 + \frac{\sigma - 1}{\bar{\sigma} - 1} \frac{\sigma - \theta}{\bar{\sigma}} \frac{1}{N} s_f}{1 + \frac{\sigma - 1}{\bar{\sigma} - 1} \frac{\sigma - \theta}{\bar{\sigma}} \frac{1}{N}} = \frac{1 + \kappa s_f}{1 + \kappa}
\]

• Phillips Curve

\[
\pi_{h,t} = \left[ k \cdot m c_t + \frac{\sigma - \theta}{\bar{\sigma}} \frac{1}{N} \frac{1}{\chi} \cdot \hat{x}_{h,t} \right] + \beta E_t \pi_{h,t+1}
\]
Main results

• Phillips Curve

\[ \pi_{h,t} = k \cdot \left[ mc_t + \kappa s_f \left( \hat{P}_{f,t} - \hat{P}_{h,t} \right) \right] + \beta E_t \pi_{h,t+1} \]
The traditional model

\[ \pi_{h,t} = \Phi mc_t + \beta E_t \hat{\pi}_{h,t+1} \]

\[ \pi_{f,t} = \Phi (mc_t^* + s_t) + \beta E_t \pi_{f,t+1} \]

\[ \pi_t = \Phi[\xi \cdot mc_t + (1 - \xi)(mc_t^* + s_t)] + \beta E_t \hat{\pi}_{t+1} \]

\[ \pi_t = \Phi[\Psi_{\pi,x} x_t + \Psi_{\pi,x^*} x_t^*] + \beta E_t \hat{\pi}_{t+1} \]

\[ \pi_t = \Phi[(\varphi + \gamma)x_t + \Psi_{\pi,z} z_t] + \beta E_t \hat{\pi}_{t+1} \]
Comments – empirical work

• Pass through evidence
  – More ambiguous than the authors suggest

• Open economy AS curve / global slack hypothesis
  – Evaluation using relative price term to capture the channel seems the right way to go
Price and ULC
Manufacturing and non-farm business

PPI - manufactured goods
Manufacturing ULC
Nonfarm business sector implicit price deflator
Nonfarm business ULC
Suggestions for future research

• Extend empirical work to look at economies that have been dealing with globalization for a lot longer than the US
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• Strategic interaction between firms is of a very limited type
  – Imamoğlu (2010)
• Competition on the basis of variety rather than price
• Traded/nontraded, home/foreign sectoral breakdown
  – Importance of distribution sector (energy intensive) as a determinant of short run inflation dynamics
• Pricing strategy of the multinational multiproduct firm
  – Baxter & Landry (2010) - IKEA