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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**!

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

  - 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)

	US dollars	Euro	Yen
Exports from Japan	54.7	12.5	30.3
Imports into Japan	70.4	3.0	24.6

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.
- Ito, Koibuchi, Sato, and Shimizu (2009): interviews with Japanese exporting firms.
- 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?

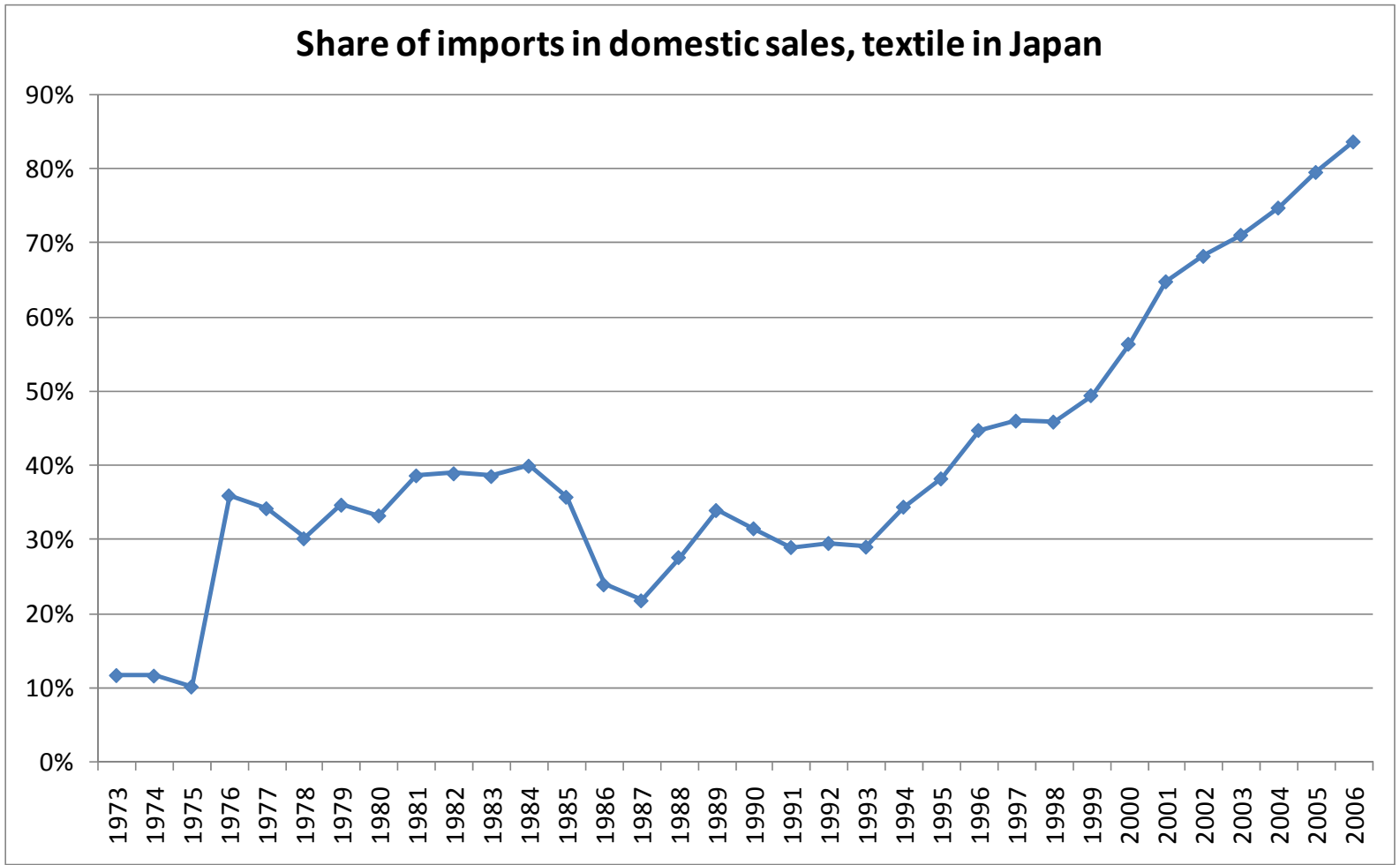
- E.g. Figure 3 in page 37.

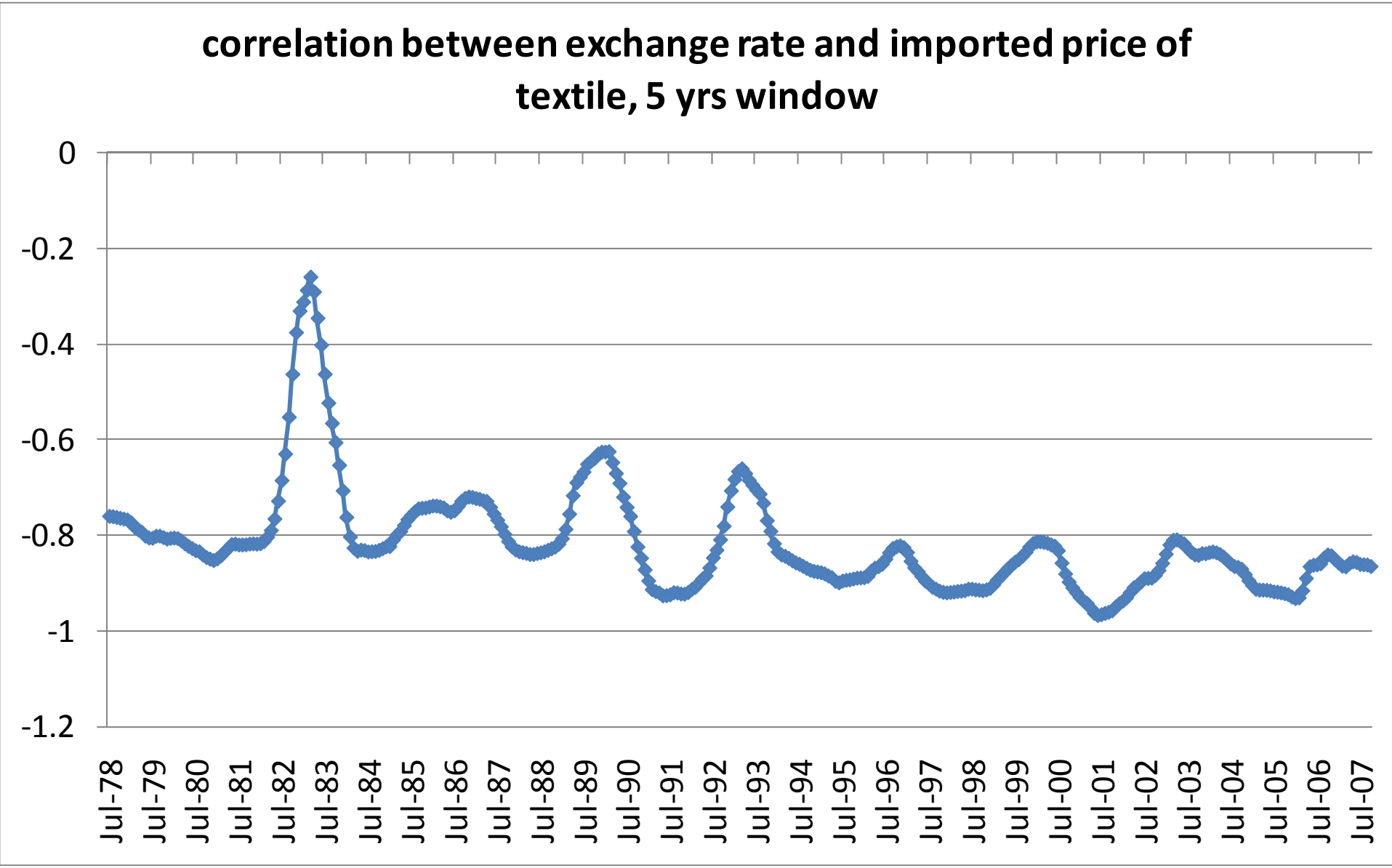
Comment 8

- 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

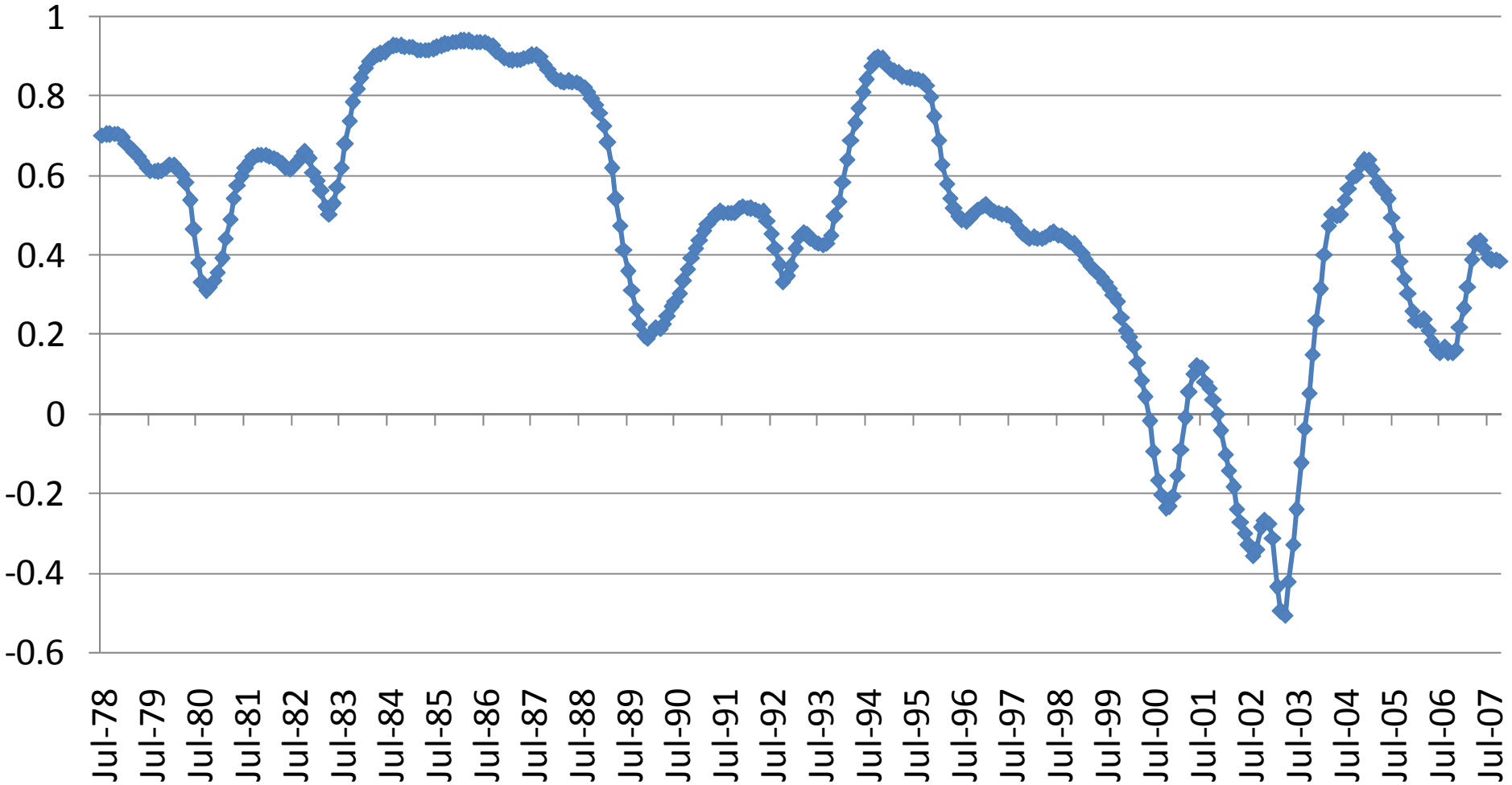
- Applicable to Japan? Case of textile.





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.