Discussion of Benigno & Faia "Globalization, Pass-Through and Inflation Dynamic"

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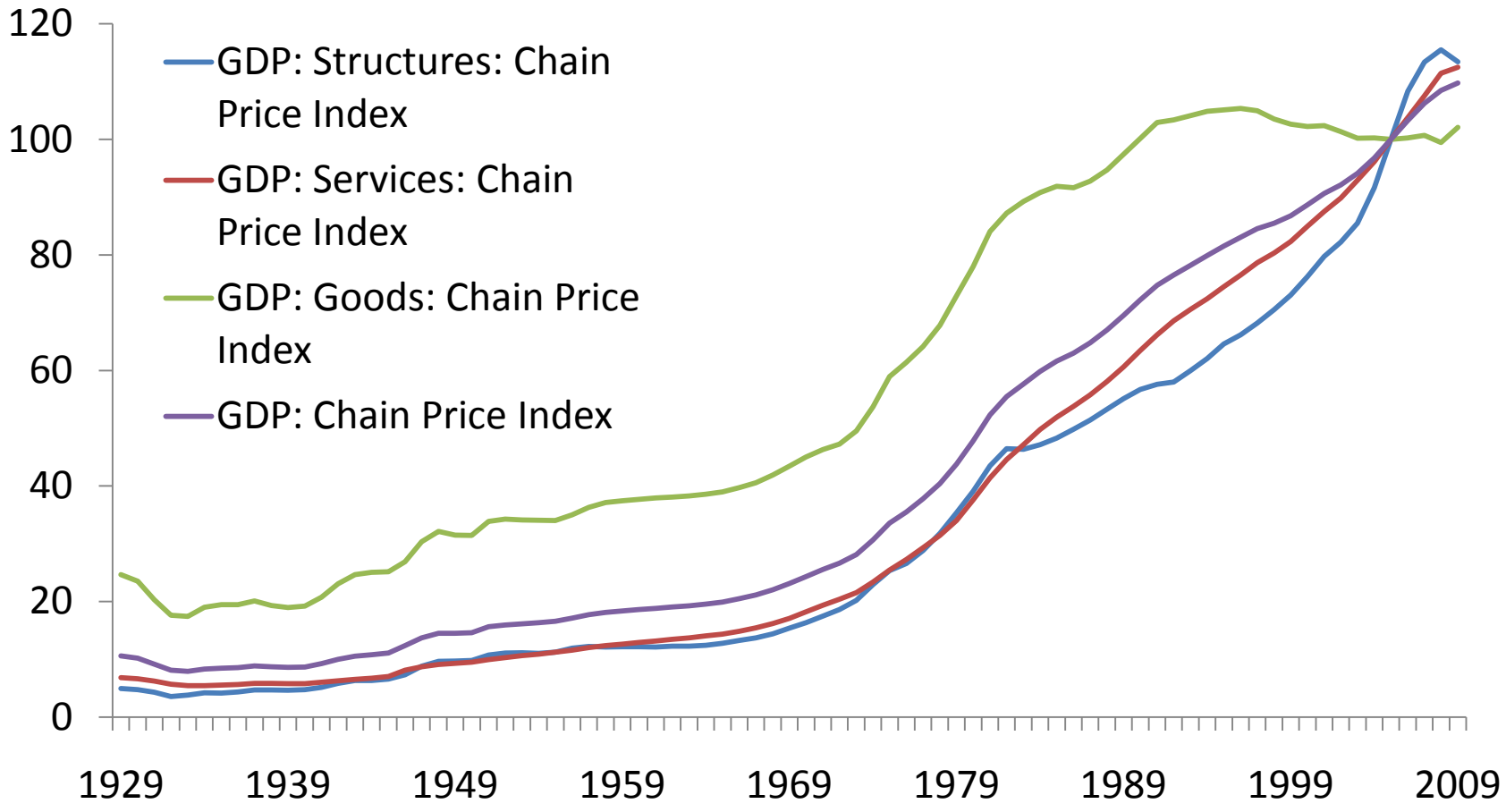
Some facts

- 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

Prices of major components of US GDP



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

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

- Phillips Curve

$$\pi_{h,t} = \left[k \cdot mc_t + \frac{\sigma - \theta}{\overline{\sigma}} \frac{1}{N} \frac{1}{\chi} \cdot \hat{\xi}_{h,t} \right] + \beta E_t \pi_{h,t+1}$$

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

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

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

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

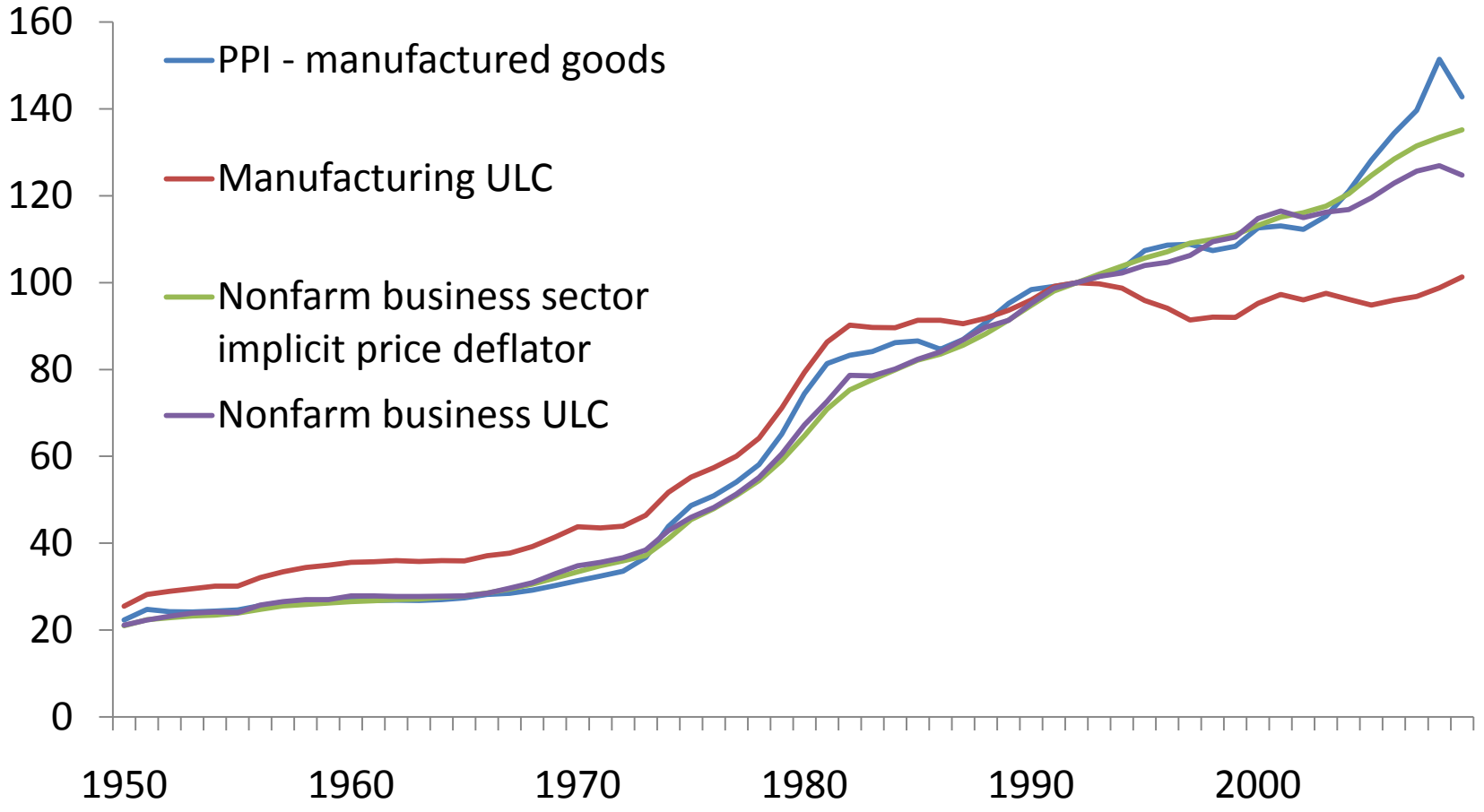
$$\pi_t = \Phi[\Psi_{\pi,x} x_t + \Psi_{\pi,x^*} x_t^*] + \beta E_t \hat{\pi}_{t+1}$$

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

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

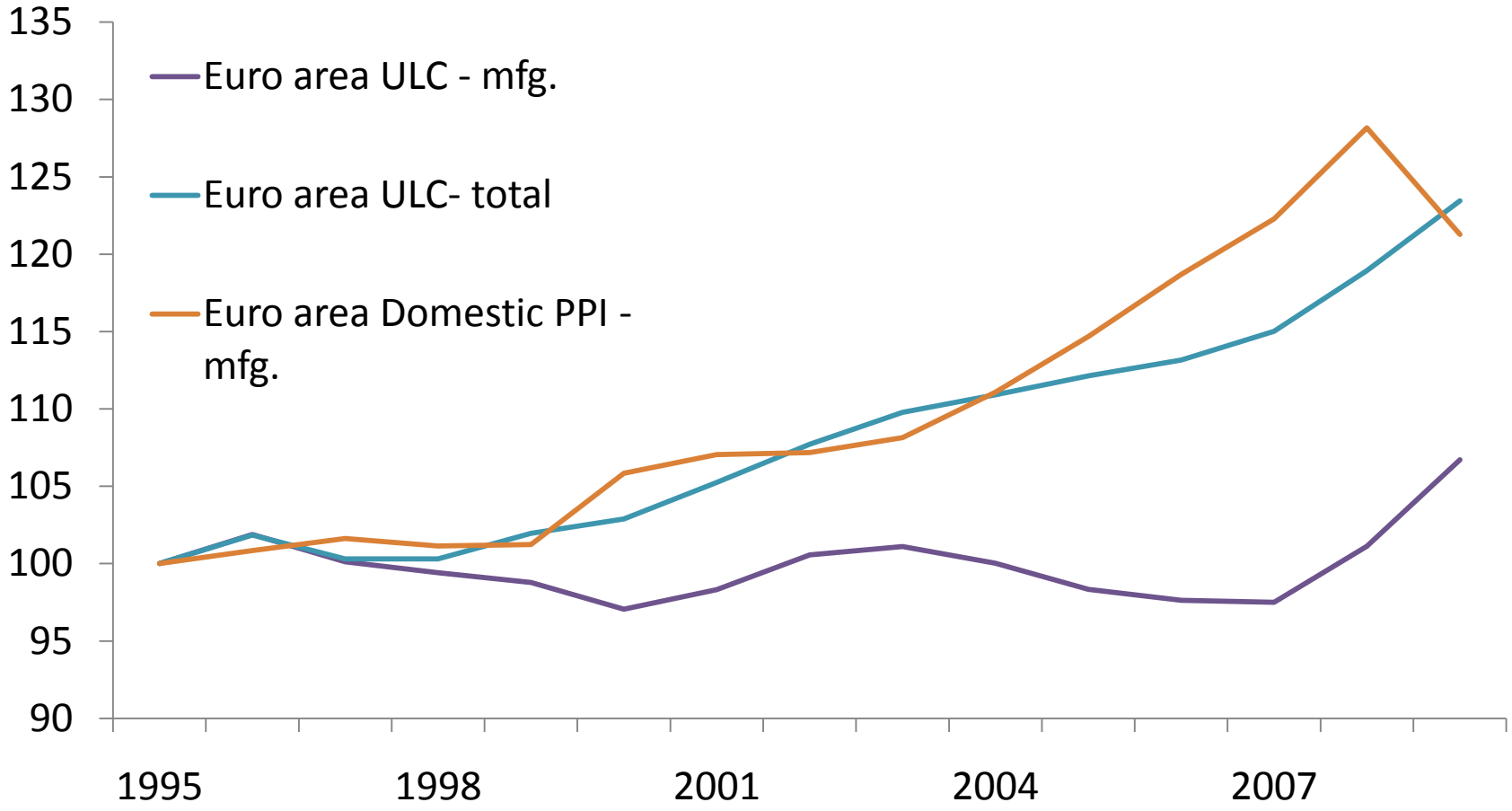
Price and ULC
Manufacturing and non-farm business



Suggestions for future research

- Extend empirical work to look at economies that have been dealing with globalization for a lot longer than the US

Euro area comparison



Suggestions for future research

- Extend empirical work to look at economies that have been dealing with globalization for a lot longer than the US
- 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