

Macro Roundup Article

Headline: [The Second Great Experiment Update](#)

Article

Link: <https://johnhcochrane.blogspot.com/2022/11/the-second-great-experiment-update.html>

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Tweet: [@johnHCochrane](#) argues that inflation potentially peaking with the Federal Funds rate < CPI is evidence that the fiscal theory of the price level is the right way to understand inflation

Summary: The news of the moment is that inflation might--might--be peaking. I just present the CPI to make the point, but there seems to be a lot of news suggesting that inflation is easing off. Newer theory, which primarily uses rational (better, forward-looking or model-consistent) rather than adaptive expectations, says that inflation is stable under an interest rate target. It follows that inflation can go away all on its own, even with interest rates substantially below inflation. With fiscal theory + rational expectations, we are having a burst of inflation to devalue government debt, as a response to the 2020-2021 fiscal blowout. But once the price level has risen enough to bring the real value of debt back, it's over. Until the next shock hits. If inflation fades away despite interest rates below the inflation rate, we have a rather striking confirmation of this rational expectations view, with stable inflation, relative to the traditional spiral-away view. So, are we headed there? It's too soon for this cautious commenter to declare victory, but I am willing to provide context and say I'm watching anxiously!

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Primary Topic: Inflation

Topics: GDP, Inflation, Op-Ed/Blog Post, Sell-by-date, Theory

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