Macro Roundup Article

Headline: Financial Stress May Do Relatively Little to Reduce Inflation

Article Link: https://www.kansascityfed.org/research/economic-bulletin/financial-stress-may-do-relatively-little-to-reduce-inflation/

Author(s)	Brent Bundick, Johannes Matschke and A. Lee Smith
Publication	Federal Reserve Bank of Kansas City
Publication Date	May 26, 2023

Tweet: An analysis from the @KansasCityFed examined the impact of monetary tightening and financial stress from banking instability, and found that financial stress is only about "half as disinflationary as monetary tightening."

Summary: A spike in the Kansas City Fed's Financial Stress Index historically leads to higher unemployment and somewhat lower inflation. A one standard deviation increase in financial stress typically portends an increase in the unemployment rate of 0.7 percentage points. Financial stress historically reduces inflation as well: inflation, as measured by the consumer price index (CPI), falls by about 0.4 percentage points in the first year following an increase in financial stress. By this metric, financial stress is about half as disinflationary as monetary tightening. Could the recent increase in financial stress generate the same disinflationary effects as tighter monetary policy? The left panel in Chart 2 shows that monetary policy tightening, as measured by an unexpected increase in the expected path of the federal funds rate (blue line), slows economic activity and raises the unemployment rate, similar to an increase in financial stress. However, despite a similar increase in the unemployment rate, inflation falls by 0.65 percentage points in the first year following monetary tightening (right panel), a considerably larger decline than we estimate following an increase in financial stress.

Related Articles: nan

Primary Topic: Inflation

Topics: Banking, GDP, Government/NGO, Inflation, Monetary Policy

Permalink: https://www.edwardconard.com/macro-roundup/an-analysis-from-the-kansascityfed-examined-the-impact-of-monetary-tightening-and-financial-stress-from-banking-instability-and-found-that-financial-stress-is-only-about-half-as-disinflationary-as?view=detail

Featured Image Link: https://www.edwardconard.com/wp-content/uploads/2023/05/Screenshot-2023-05-26-at-2.13.29-PM.png