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Macro Roundup Article

Headline: What Caused the U.S. Pandemic-Era Inflation?

Article Link: https://www.brookings.edu/wp-content/uploads/2023/04/Bernanke-Blanchard-conference-draft_5.23.23.pdf

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Tweet: .@benbernanke and @ojblanchard1 argue that bringing the current inflationary episode to target implies an unemployment rate of 4.3%, up from 3.4% last month.

Summary: Figure 12 shows the estimated sources of inflation from 2020Q1 to 2023Q1. For comparison, the continuous line shows actual inflation. (The inflation data are quarterly, at annualized rates, and thus more jagged than the annualized series we often see.) Figure 12 yields several conclusions. First, the contributions of food [light blue] and (especially) energy [dark blue] price shocks to the pandemic-era inflation were large. Energy price shocks in particular account for much of the rise of overall inflation in late 2021 and the first half of 2022, and the for the decline in inflation in the second half of 2022. The large and extended contributions of commodity price shocks to inflation shown in Figure 12 are not inconsistent with our earlier finding that price shocks tend to have transitory effects on inflation, as both energy and food prices rose continuously over much of the period (see Figures 4 and 5), which our procedure interprets as a series of positive shocks. Second, the combination of increased demand for durables and shortages [yellow] associated with disrupted supply chains was the dominant source of inflation in 2021Q2, and the effects of supply chain problems, both direct and indirect, remained significant through the end of our sample period. Third, and importantly, the contribution to inflation of tight labor-market conditions [red] —the leading concern of many early critics of U.S. monetary and fiscal policies—was quite small early on, and indeed was negative in 2020 and early 2021 as labor markets suffered from the effects of the pandemic recession. However, over time, as the labor market has remained tight, the traditional Phillips curve effect has begun to assert itself, with the high vacancy-to-unemployment ratio becoming increasingly important, though by no means dominant, source of inflation.

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