BOSTON COLLEGE

Laura Veronika Gati <gati@bc.edu>

One-on-one conversation

Sheremirov, Viacheslav <Viacheslav.Sheremirov@bos.frb.org>   Wed, Sep 23, 2020 at 4:09 PM
To: Laura Veronika Gati <gati@bc.edu>

Laura,

Yes, it's outside the time slots I had in mind for today/tomorrow. Let's look for other time, next week or the following.

Because time may be of essence for you, let me outline some comments below. We can discuss them in more detail when we chat, but I hope they are self-explanatory. Overall, I think it's an interesting paper on a timely topic, and I hope it'll generate much attention.

Hope you find the comments below helpful.

Slavik

1.   My primary comment/concern is about your main quantitative result. If I understand correctly, in your model, if long-term inflation expectations increase, say, from 2.0% to 2.1%, the central bank should increase its policy rate from, say, 0% to 5%? This response is quite large and needs to be carefully explained.

> a.   Questions: Is it a puzzling feature of a general class of NK models with learning of a certain type (like the forward-guidance puzzle in the standard model) or a feature of the particular learning process that you study? Under what conditions, if any, this response can be smaller?

> b.   I recommend that you present a range of numbers, depending on different values of the parameters and maybe even modeling assumptions.

> c.   Less important: When presented to a policy audience, I would also discuss whether the policy prescription from the model is easy to implement in practice. Is it easy for the policymaker to measure long-run expectations? Are the expectations persistent enough to justify excess volatility in the policy rate? (Remember that empirical estimates of the Taylor rule reveal central banks' preference for policy rate smoothing.)

2.   Motivation:

> a.   I'm not sure that showing the time-series of survey expectations alone is the best way to motivate your question. As Philippe pointed out, the dynamics of expectations in that graph, at least to some extent, can be explained by the specifics of target implementation in the U.S., without necessarily indicating unanchoring. Many papers argue that the Fed de facto targeted inflation in the 2000s (flat expectations in your graph). When the target was later officially announced to be 2%, the expectations started to drift down towards that lower target. These dynamics could be explained by mechanisms different from the one in your paper, such as infrequently updated information sets a la Mankiw and Reis.

> b.   The regression analysis (moving windows) perhaps came a bit early, and may generate some unnecessary discussion. As far as I understand from later in your talk, this specific equation is derived from your model, which is great. But when shown before the model, it's not that clear why you estimate it. I would move it farther in your talk.

    c.   Suggestion: A lot of discussion of unanchored expectations has been generated recently, as inflation (specifically, the Fed-preferred PCE measure) has run consistently below the target of 2% for a prolonged period. Maybe you could leverage this observation for your motivating slides? First, you could show that when the Fed announced the target, inflation expectations started to drift down toward the target. Then, show that inflation has been below the target for a while and discuss potential credibility issues—and a risk of unanchoring—in the context of your paper. As a bonus point, you may also mention the recently announced change in the inflation targeting framework and its potential implications for policy through the lens of your work.

3.   Given the scope of empirical literature on expectations, the model could speak more closely to the data. For example, does your model generate testable predictions that are consistent (or not) with recent empirical evidence? (Philippe Andrade is a good person to talk to about it.) Even better if the paper had some empirical results. JMPs that showcase the ability to do both modeling and data analysis tend to appeal to wider audiences. Some policy institutions, in particular, have a strong preference for candidates that are well versed in data work.

4.   Miscellaneous:

    a.   You mentioned in the seminar that the model is calibrated based on the Woodford book. As it was published in 2003, some calibration may be outdated. For instance, Nakamura and Steinsson's empirical estimates of Calvo frequencies came out in 2008. [Also, the draft refers to Interest and Prices as Woodford (2011), not 2003. A typo?]. I recommend adding an extra column to the calibration table with references to <u>recent</u> papers on which it is based.

    b.   If you're looking for further extensions of your model, you could consider a case when consumers and firms learn differently and optimize based on distinct expectations operators, $\hat{E}_c$ and $\hat{E}_f$. In a simple case, what if consumers did the learning and firms had full information ($\hat{E}_c = \hat{E}$ and $\hat{E}_f = E_{RE}$)?

5.   Finally, you may want to consider different presentation strategies depending on your audience. There'll be audiences like yesterday, with people who are already interested in potential unanchoring of expectations and its implications for policy. Other audiences may care more about your modeling or need more convincing about the importance of expectations. So, you could think of reshuffling some slides here and there depending on whether you present at a policy institution, a department with many macro faculty, or at a department relatively scarce in macro.

[Quoted text hidden]