Intuitions – approximately in order of slides

* Anchored expectations: long-run expectations stay where they are regardless of how actual inflation moves around. Important because long-run E determine how firms set prices, so if long-run E stable, prices are stable
* The right model: Peter’s response: (Notes 14, p. 76): “We observe in data (which the CB observes too) phenomena that reflect fundamental deviations from RE (in a particular way) and CB-ers ask: ‘what should I do?’ I take a canonical model and tailor to a) explain the phenomenon b) tell central bankers what to do. My paper is the first to answer these questions.”
* Regression: “The RE assumption regarding the Fed’s target implies LR-E will be 2%. Yet in the data we see E not only varying away from 2%, but doing so in a way that’s systematically related to forecast errors. Moreover, what this means is that it’s not enough for policy to tell the PS that inflation will be 2%, but it needs to deliver to get E back up.” (Peter, Notes 14, p. 74)
* Regression: it’s not a test of a particular theory, but what I’m saying is “if the 2% target is fully credible, LR-E should be 2%. Instead the regression shows sensitivity to fe. ‘E deviate from 2% all the time and they do so in response to observed movements in inflation.’ So if you’re a CB-er, what do you do about this to get E anchored? I can’t rely on a regression b/c not causal, so I develop a fully developed model w/ a departure from RE.”
* Expectations:
* Not learning the slope corresponds to the fact that higher-order expectations are in the background (Susanto, Notes 14, p. 82)
* Dgain and cgain vs. endogenous gain: the first two are not true in data. Recall motivation slide: we see that LR-E respond in a time-varying way to inflation surprises. That’s why it is important to look at monpol in an endogenous gain setting. Carvalho et al 2019 showed that Great Inflation was a period of high gains, again an endog gain explains that, c or d don’t. (Jenny)
* Cgain looks like noisy info in the data (Coibion & Gorodnichenko 2015) (Jenny)
* Estimation> 2015 period: something might be going on with oil prices: World Bank blog: “ 2014-16 collapse in oil prices” was the biggest drop in oil prices in modern history (70% drop). It was mainly driven by efficiency gains in shale oil production. According to the World Bank, there was also low demand. Goro et al have shown that consumer expectations very sensitive to oil prices b/c gasoline is salient. (Jenny)
* TC: In RE, optimal thing to do is to move pi and x to absorb a cost-push shock. In adaptive learning, a new thing is Ex, you can push some of the shock to the future. (Jenny)
* Asymmetry is there in policy, but it doesn’t show up in the plot b/c I’m plotting interest rate against pibar, not against fe.
* Optimal policy is large, yes, but it’s large because such aggressiveness allows the CB to stabilize pibar, so it’s never necessary 🡪 show that model spends most of its time in the pibar close to zero region. It spends more than 60% of time in the <90 bp movements in int rate (Jenny)
* Goodfriend 1993 showed that to subdue inflation scares, Fed repatedly raised bu hundreds of bp, e.g. raised by 300 bp in March 1980
* IRFs with cgain against unanchored: emphasize that the only diff between the two is the gain, so that policy wants to avoid letting the gain be high (Jenny)
* TR less aggressive than RE: refer to the debate between Orphanides vs. Preston and emphasize my contribution (Philippe)
* Same: Gurkaynak, Sack and Swanson 2005 find that interest rates in the future go negative after a positive int rate shock today, b/c corr(int, E(pi future) < 0).
* Same: in RE the same channels are there it’s just that interest rate expectations are rational. Here, they are partly comprised by a non-rational, more volatile expectations (of inflation) and so they move more.