Discussion: Inflationary Effects of Fiscal Support to Households and Firms

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Inflation has recently surged across the world to highest levels in decades. Ongoing debate: supply chain pressures? fiscal support measures? labor market tightness?

Research question: Did fiscal measures following Covid-19 drive the surge in inflation?
The paper in a nutshell

- **Data:** 10 countries, Feb 2020 to Sep 2021 (weekly frequency)
  - Fiscal support by size and targeted group (textual analysis of policy announcements)
  - Severity of the health shock (stringent index & Covid-19 deaths per capita) + Consumer sentiment + Macro data

- **Empirical Strategy:** Local Projection Method
  - Impulse response of inflation to cumulative fiscal support (% of GDP) for each week \( s = 0, \ldots, 16 \)
  - Controls: Covid-19 severity, 3M gov bond rate, diff between 2Y and 3M gov bond rate, country and month fe

- **Results:**
  1. Fiscal measures, in particular those for consumers, have positive effect on inflation
  2. Effect amplified by consumer sentiment about current conditions
Comment 1: Labor market tightness

- Following Covid-19, labor force participation remains low + lower willingness to work + higher reservation wages (Faberman et al, 2022) → tight labor market

Strong wage growth at the bottom → positions have become more difficult to fill

To gauge the role of fiscal measures on inflation, it is important to account for labor supply constraints

→ Amiti et al (2022) find a strong positive pass-through from wages to producer prices
Comment 2: Stimulus spillovers through trade

- HEADLINE INFLATION POTENTIALLY AFFECTED BY FISCAL SUPPORT IN OTHER COUNTRIES THROUGH TRADE LINKAGES

  1. The surge in the import prices

  2. Extra increase demand through exports

(e.g. US can be exposed to the Canadian fiscal stimulus, both through a high import share (1) and a high export share (2))

- IF COUNTRIES THAT ENGAGED IN LARGER FISCAL SUPPORT MORE LIKELY TO TRADE WITH EACH OTHER, THEN...

  ...Is the surge on inflation driven by domestic fiscal stimulus or spillovers of foreign fiscal support?
Comment 2: Stimulus spillovers through trade
What to do?

- Measure exposure to foreign fiscal stimulus: trade-weighted ave of trade partner’s stimulus measures

\[
\text{Exposure through imports}_c = \sum_{j \in \text{Partners}(c)} \text{import share}_{cj} \cdot \text{Fiscal Stim}_j
\]

\[
\text{Exposure through exports}_c = \sum_{j \in \text{Partners}(c)} \text{export share}_{cj} \cdot \text{Fiscal Stim}_j
\]

Add exposure to main specification to gauge (i) how much of the rise inflation driven by domestic fiscal measures and (ii) measure the extent of fiscal spillovers through trade

- Measure inflation using GDP Deflator: not affected by import prices, but only by increase in demand
Comment 3: Take-up of public loan guarantees

- The use of public loan guarantees has been heterogeneous across countries
- How does the take-up of temporary correlate with size of fiscal support?
  → If negative correlated, there is a downward bias in the estimated effect of firm support
Comment 4: Measurement of supply chain disruptions

- Measure of all stockouts from Cavallo and Kryvtsov (2021) is the sum of...
  - Temporary stockouts = out-of-stock indicator → directly linked to supply disruptions
  - Permanent stockouts = discontinued products → may reflect supply disruptions or changes in tastes/preferences
  → robustness using only temporary stockouts, the only shown to be correlated with inflation
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- Caveat: data for whole sample not available → results reflect different sample or control?

- Alternative: use sub-indices of Purchase Manufacturing Index (IHS Markit)
  1. Backlogs of work index → extent to which companies are struggling to cope with demand
  2. Delivery times index → the extent of supply chain delays in an economy

→ Advantage: data available for the whole sample
Comment 5: Amplification effect of supply constraints

- Controlling for economic activity & supply chain disruptions, there is a positive relationship between fiscal measures and inflation

- But, to what extent negative shocks to supply capacity during the pandemic period set the stage for demand shocks to have outsized impacts on inflation?

- Was the inflation effect of fiscal measures amplified by supply chain disruption or labor supply constraints?
- **Fiscal measures:**
  How are wage subsidies treated: as a targeted to firms or consumers?

- **Consumer sentiment as proxy of economic activity:**
  Is sentiment *really* capturing supply? Why not use econ activity measures (PMI & IP)?
  Isn’t it sentiment more proxy for (future) spending rather than production?

- **Empirical specification:**
  Estimate version of main specification with both firm and consumer fiscal support as independent variables
The paper tackles an important question with nice data on fiscal measures. **Novelty**: distinction between measures targeted to consumers and firms.

Understanding the role played by fiscal measures on inflation requires an empirical framework that isolates demand from other potential drivers such as changes in labor market.

Explore the role of trade linkages & understanding the interaction between fiscal measures and other drivers would bring a more complete picture.