

## Discussion: Inflationary Effects of Fiscal Support to Households and Firms

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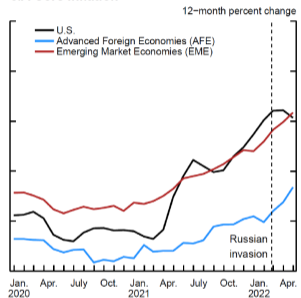
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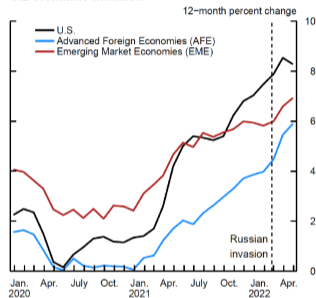
# Context & Motivation

## Evolution of Inflation during the COVID-19 Pandemic

### 6.A Core Inflation



### 6.B Headline Inflation



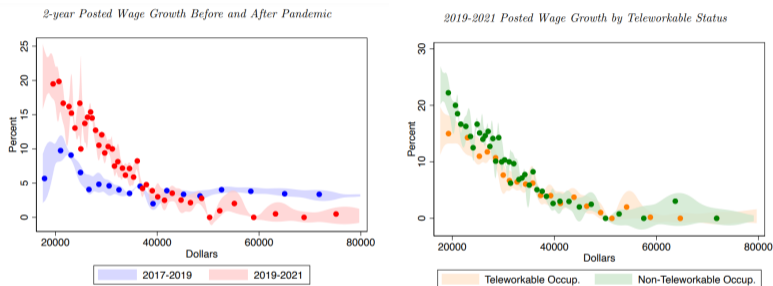
- Inflation has recently surged across the world to highest levels in decades
- Ongoing debate: **supply chain pressures?** **fiscal support measures?** **labor market tightness?**
- **Research question:** Did **fiscal measures** following Covid-19 **drive the surge in inflation?**

# 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  $s = 0, \dots, 16$
  - 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**



Source: Crump et al (2022)

- 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

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

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

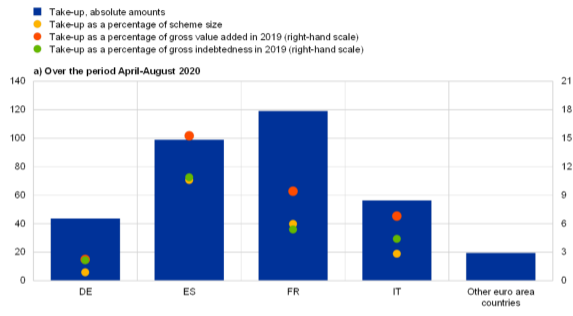
Add exposure to main specification to gauge (i) how much of the rise inflation driven by domestic fiscal measures and (ii) measure the extent of fiscal spillovers through trade

- Measure inflation using **GDP Deflator**: not affected by import prices, but only by increase in demand

## Comment 3: Take-up of public loan guarantees

### Take-up of loans under public guarantee schemes

(left-hand scale: EUR billions, percentages; right-hand scale: percentages)



- 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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→ robustness using **only temporary stockouts**, the only shown to be correlated with inflation
- **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?

## Other comments

- **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

## Taking Stock

- 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