Discussion of
“Monetary Policy During Unbalanced Global Recoveries”
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Global Research Forum on International Macroeconomics and Finance
NYFed, November 2022
Overview

**Question:** What is the national optimal monetary policy when there is a global rise of demand for tradable goods?

**This paper:**
- Inflation is the cost to bear to reduce real wages and hence stimulate production of tradable goods
- National monetary policy has externality on global supply of tradable goods → deflationary bias
- During times of high global demand for tradables, expansionary monetary policy abroad has deflationary spillovers at home
What the Paper is About

Set Up

- continuum of small open economies $i \in [0, 1]$ identical to each other
- continuum of infinitely-lived households with disutility cost from inflation
- two consumption goods: tradables and non-tradables with $\omega = \text{share of tradable goods in consumption basket}$
- labor only factor of production, inelastically supplied and fully mobile

\[ Y_t^N = L_t^N \quad \text{and} \quad Y_t^T = (L_t^T)^\alpha \]

- short run ($t = 1$): reallocation shock ($\omega \uparrow$) and $W_1 = 1$
- long run ($t \geq 2$): economy goes back to steady state and flexible prices
Closed Economy

- Two key equilibrium conditions: labor demand and relative good demand

\[ Y^T_t = \alpha^{\frac{\alpha}{1-\alpha}} \left( \frac{W_t}{P_t^T} \right)^{-\frac{\alpha}{1-\alpha}} \]  
and  
\[ Y^N_t = \frac{1 - \omega_t}{\omega_t} \frac{P_t^T}{P_t^N} Y^T_t \]

- \( t = 0 \): SS with full employment and zero inflation \((P^T_1 = P^N_1 = 1)\)

- \( t = 1 \): shock \( \omega_1 > \omega_0 \) with nominal rigidities \((P^N_1 = W_1 = 1)\)

- What is optimal monetary policy in a closed economy?

- If \( P^T_1 = 1 \), production of tradable does not increase and labor demand in non-tradable sector decreases \( \rightarrow \) unemployment

- Increase in \( P^T_1 \) increases production of tradables and of non-tradables!
Open Economy

- assume all countries are hit by the same reallocation shock
- consider a monetary expansion in country $i = \text{increase in } P^T_{i_t}$
- externality: the increase in $Y^T_{i_t}$ reduces pressure in global market for tradables
- equilibrium in country $j$:

$$Y^T_{jt} = \alpha \left( \frac{W_{jt}}{P^T_{jt}} \right)^{-\frac{\alpha}{1-\alpha}}$$
and

$$Y^N_{jt} = \frac{1 - \omega_t}{\omega_t} \frac{P^T_{jt}}{P^N_{jt}} C^T_{jt}$$

- even if monetary policy abroad does not change, more production in non-tradable sector
- $\rightarrow$ deflationary bias
Two contributions

• **positive result**: inflation rates in tradable goods are *strategic substitutes* across countries

• if a country chooses higher inflation, it makes tradable more abundant in the world and reduces incentives in other countries to stimulate tradable production

• **normative result**: Nash equilibrium inflation rates are too low relative to optimum

• this is due to the positive externality
Scarcely Good

- What if a scarce good (e.g. oil) is used for the production of tradables?

\[
Y_{it}^T = (L_{it}^T)^\alpha (X_{it})^{(1-\alpha)}
\]

with

\[
\sum_{i \in [0,1]} X_{it} = \bar{X}
\]

- if price of tradables increases, there is more production in the domestic tradable sector
- → more domestic demand for scarce good that reduce its availability abroad
- → less consumption of tradable abroad and hence of non-tradable as well
- can this lead to inflationary bias?
Fiscal Policy

- in Mundell-Fleming framework, international spillovers of fiscal and monetary policy are different
- why?

- monetary policy causes exchange rate depreciation and lowers cost of imported goods for foreign countries $\rightarrow$ lower inflation abroad

- fiscal policy causes exchange rate appreciation and increases cost of imported goods for foreign countries $\rightarrow$ higher inflation abroad

- that is why concern for emerging economies when the US does a combination of expansionary fiscal policy and contractionary monetary policy

- does this model generates a similar tension? if not, why not? maybe depends on the composition of government spending?
Other comments

- standard microfundation of inflation cost in the utility function would need rigidities also in tradable sector ...
- what if large open economy? Does the general equilibrium effect on interest rates amplify the externality?
- what if labor mobility across sectors is costly? maybe the persistence of the shock then matters?
- very nice paper!