Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Discussion: The Effect of Monetary Policy on Inflation Heterogeneity along the income distribution

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Key findings (1)

1. Stylised facts on differences in expenditure shares and inflation across the income distribution

- Higher for lower income households – because of composition of expenditure basket
- Biggest differences when headline inflation is high
- Differences smaller when looking at food (or FMCG) from household panel data.
- **Well known in the literature – but useful to see in EA data, and for several countries.**

2. How do exogenous monetary policy shocks impact (household-specific) inflation?

- Right direction, bigger impact on food/FMCG inflation (exchange rate channel)
- Monetary tightening with common prices: inflation for high-income groups falls by less than inflation for low-income
- Monetary tightening with income-specific prices: opposite effect, why? High income households shop around.
- **Some similar results to the literature, but also some new results.**

Key findings (2)

3. Innovative approach comparing Paasche and Laspeyres indices

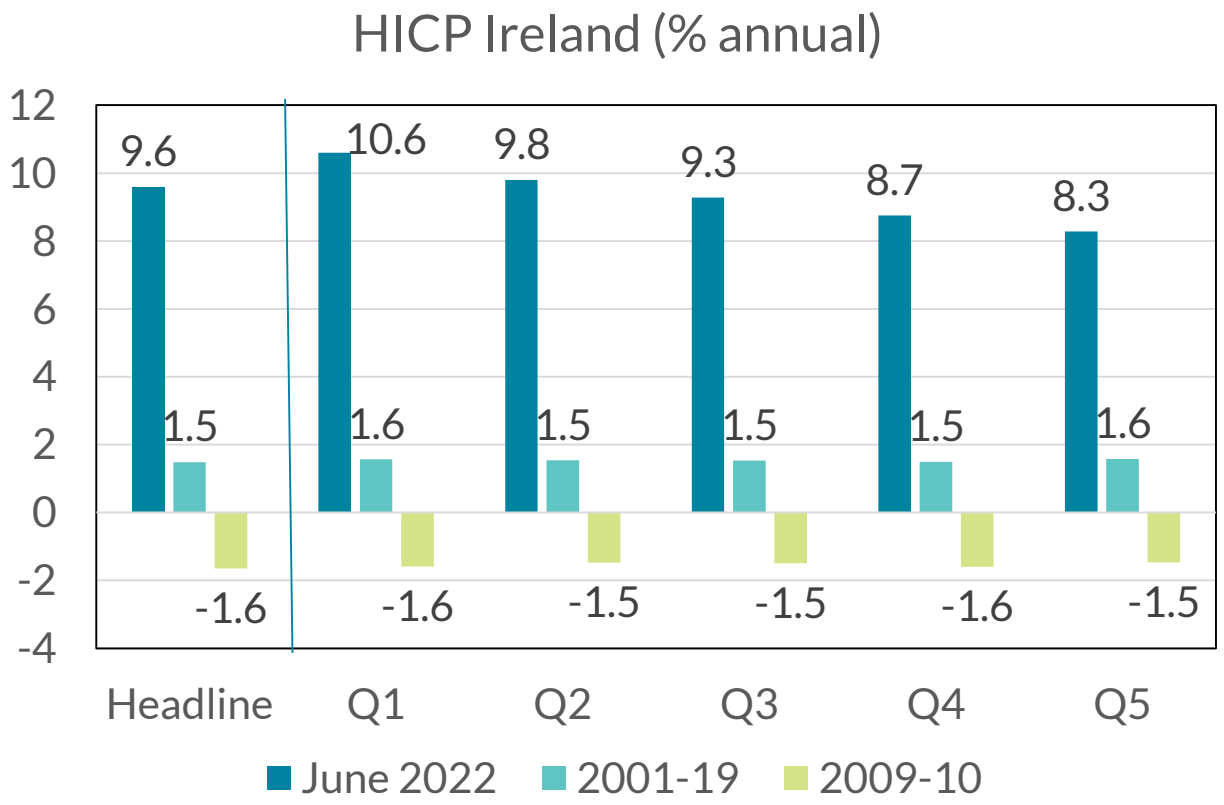
- On average, low income hhlds substitute more effectively, especially when price increases are small.
- But time-varying (or varying according to level of inflation) e.g. smaller Paasche-Laspeyres gap difference from 2009-13.
- Large substitution effects flip the sign of the high-low income inflation differential under Paasche.
- **This matters for policy! – 'product substitution is an integral part of shopping behaviour' – but substitution has its limits**

4. Differential response of shopping behaviour to MPOL shocks

- High-income households change their behaviour relative to low-income households
- High-income reduce *quantities* purchased, relative to low-income – but with a (long) delay
- **Contrary results from Paasche and Laspeyres: different consumption shares imply that inflation of high income responds relatively *less* to MPOL; different shopping behaviour implies that inflation responds relatively *more* to MPOL.**

Question 1. The other 60%?

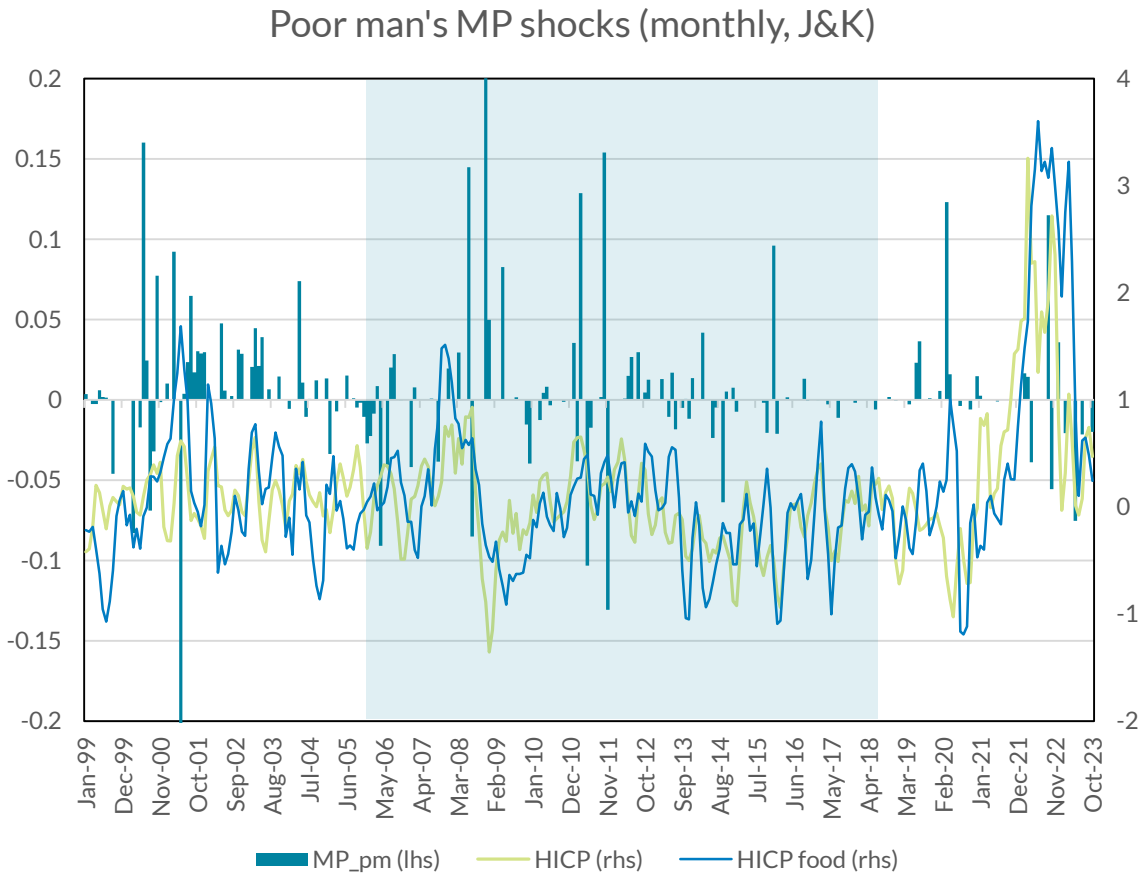
- The authors say they are studying inflation 'along the income distribution'
- But really a comparison between the top and bottom groups – so what about the other 60% of households?
- Who are they like? Basket story looks monotonic, but behavioural story?



Question 2. GfK/Kantar results generalizable to overall inflation?

- Paper talks about 'inflation' when GfK/Kantar uses food and beverages items (FMCG)
- Good data – because there are a large number of similar items with different price levels in the same category within food and so a lot of substitution can happen and within a relatively short time frame.
- But, is this high substitutability likely to be the case for other HICP items?
- What about substitution between *broad* product categories, e.g. we know that *durables* spending is most sensitive to shocks – unlikely to change results on impact of MPOL on hetero of FMCG, but does it limit what we can infer from these results about the macro effects of MPOL?
- MPOL 'looks through' – Communications often focuses on core (goods & (domestic) services) or underlying inflation metrics.
- Check CES questions about response to shocks, how do households adjust?
- Not much in WP on cross-country differences, would be nice to see more, e.g. do institutional/structural differences – like greater prevalence of job retention schemes, or low U – matter?

Question 3. The 'poor man's' MPOL shocks



- Exogenous? Yes
- Concerns about power? Acknowledged in the paper
  - 2006-18:
    - 55% of months = 0;
    - 42.5% of months positive/negative
- 2006-18 MPOL shocks largely 'unconventional' – any reason to think results might differ for conventional MPOL?

- Extension? Look at information shocks (especially post-pandemic), how do these shift behaviour? Do information shocks influence expectations?

Question 4. What exactly are the channels here?

- F5. Response of inflation differential to MPOL shock
  - Do time-lags correspond to typical lags we estimate for MP transmission?
- F6. Controlling for differences in consumption shares *and* prices paid, flips previous result (neg. differential)
  - If a quality substitution story – why only temporary?
- F8. Substitution by low-income households less able to mitigate impact of inflation when inflation is high? Is this just a broad-based inflation story?

- F9 + 10 seem counter-intuitive, at least relative to narratives in HANK literature, which attribute greater income risk to lower income households – maybe just that higher income households are *more able* to change shopping behaviour, even if shift in the income risk is different (vs. low income).

- Combining the results in F8-9-10, another side-effect of MPOL? i.e. goal is to return inflation to target after a deviation, but increases inequality because higher-income households have more scope to change shopping behaviour – especially when inflation is high. Is this a case for 'temporary & targeting' fiscal cost-of-living supports?

Question 5. Laspeyres might overstate inflation, Paasche might understate, so where does the truth lie?

- In-between?
- Can you construct a Fisher Index using GfK/Kantar – geometric average of Laspeyres and Paasche
- Such a metric might be most informative when inflation is changing by a lot in a short time period – so, after 2018 would be very interesting.
- But, given only FMCG, and results in Figure 8 [high-low gap in Paasche falls at high inflation], maybe not much change?

Overall… a very nice paper

- Sheds light on a previously unexplored channel of monetary policy and uses European data
- Shows value of micro data on prices and quantities at household level
- Important results, especially in light of the experience of the last few years
  - Question of substitutability lingers over the analysis of the post-pandemic inflation surge
  - And not just for MPOL – fiscal cost-of-living measures?
  - Look forward to seeing the extension of the data set and analysis after 2018 ☺
  - Symmetry: MPOL tightening versus loosening?
  - Does state of the world matter: e.g. tightening when unemployment is low (i.e. $u<u^*$) or high?
  - Other MPOL transmission channels: could compare other groups, not just by income, e.g. mortgage (flexible/fixed) *versus* no mortgage