Discussion of World Economic Outlook 2024, chp.2 ‘The Great Tightening: Insights from the Recent Inflation Episode’

Cepii, 6 November 2024

The chapter

- Analysis of the causes of the 2022-2023 inflation surge.
  - Emphasis on supply bottlenecks with high demand (due to drawdown of savings) and commodity price shocks

- Rich sectoral analysis (energy dependence, price flexibility) + global model with input-output linkages

- Why has disinflation been less costly than in the past?

- Counterfactual policy scenarios, and policy lessons: when supply bottlenecks widespread across sectors, steeper Phillips curve, then disinflation less costly

Missing things: exchange rates

- Exchange rates (especially for EMDEs)
  - In floating exchange rates, supply or commodity price shocks may depreciate exchange rate, and affects inflation. Pass through?
  - In fixed exchange rate: what did increase faster, P*or P?
  - In fixed exchange rate, was monetary policy constrained?

- Important for policy lessons (see also discussions in the 1970s): are floating exchange rates better able to cope with such global price & supply shocks?

Missing things: price controls & fiscal policy

- How did price-suppressing policies (cf box n°2) affect the Phillips curve and the conditions of monetary policy responses?
  - the chp. recognises that there is no wage-price spiral > wages have risen by less than inflation > workers are bearing the cost . Price Phillips curve steeper but not wage Phillips curve
  - Would wages have increased more without subsidies and price controls?
  - Is the ‘cost of disinflation’ lower because of subsidies & price-suppressing policies? Good ‘second best’ policy mix?
- Stability of wages > loss of purchasing power > decrease in agg.demand . How it is considered in the model? Could inflation be temporary without CB interventions?

Missing things: financial stability

- Box n°1 recognizes that quantitative tightening & rate hikes caused financial stability issues (especially in US) which required additional CB interventions
- Financial systems was weakened by years of low rates… but strenghtened by high savings during COVID
- Sudden rate hikes have caused financial problems in the past (1982; early 1990s). What did avoid a financial crisis this time and can it be avoided next time?

Policy lessons

- Key message: identifying supply bottlenecks is key for taking appropriate monetary policy measures
- How it is possible *ex ante*?

- Contrary to the 1970s, inflation was stabilized without applying the Taylor principle (i.e. nominal interest rates remained below inflation). Why? Expectations or other shocks/policy measures?