



Perspectives on Inflation and Real Rates

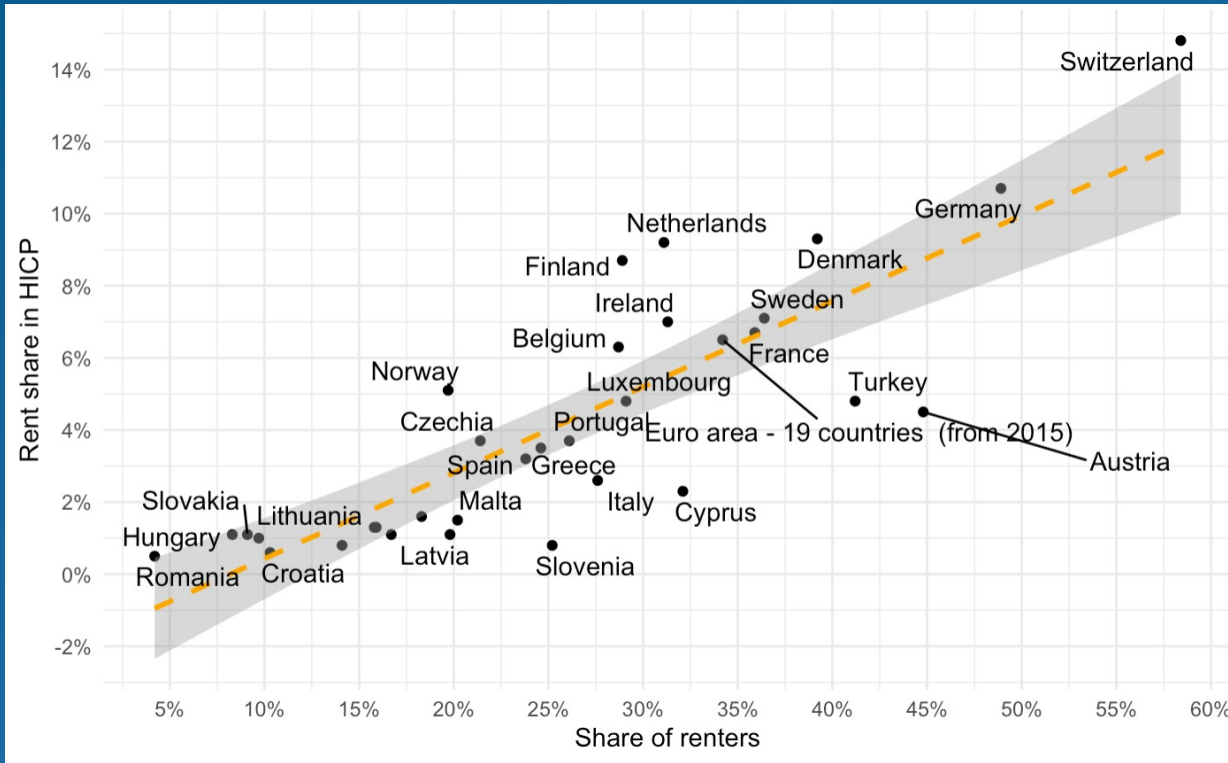
AFGAP - Zoom Event - May 20, 2021

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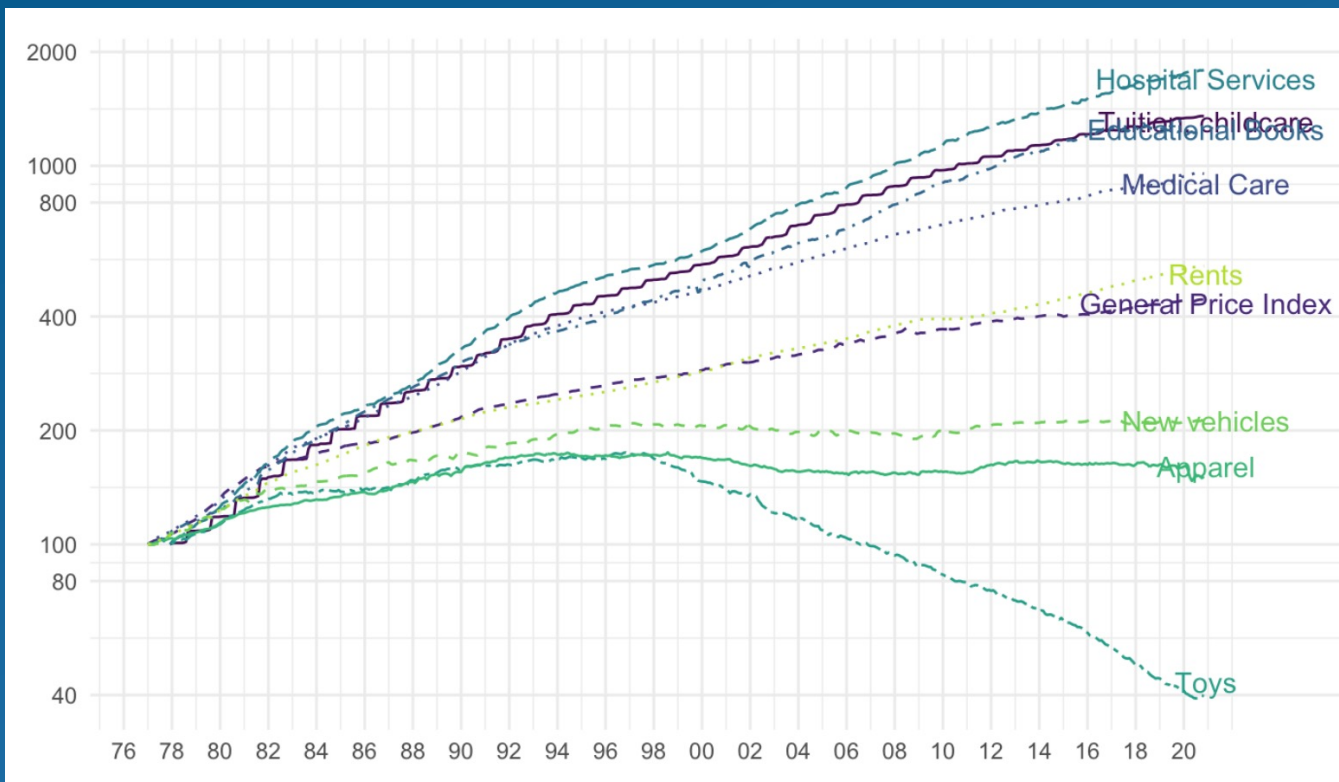
Definition of Inflation

- Consumer Price Inflation (CPI, PCE in the U.S.): average change in prices over time that consumers pay for a basket of goods and services.
- Many different ways to measure inflation: GDP deflators, wage inflation.
- Difficult to compare, over time and across countries.
- **Example** : Treatment of Owner-Occupied Housing = very challenging.
 - US: change in 1983.
 - EU: HICP (**Harmonized** Index of Consumer Prices) = only counts rents, and depends on the share of renters. Moving towards including Owner-Occupied Housing (OOH) in the CPI.
 - EU: most countries have their own price indexes including OOH.
- Other examples: quality improvements, new goods, etc.

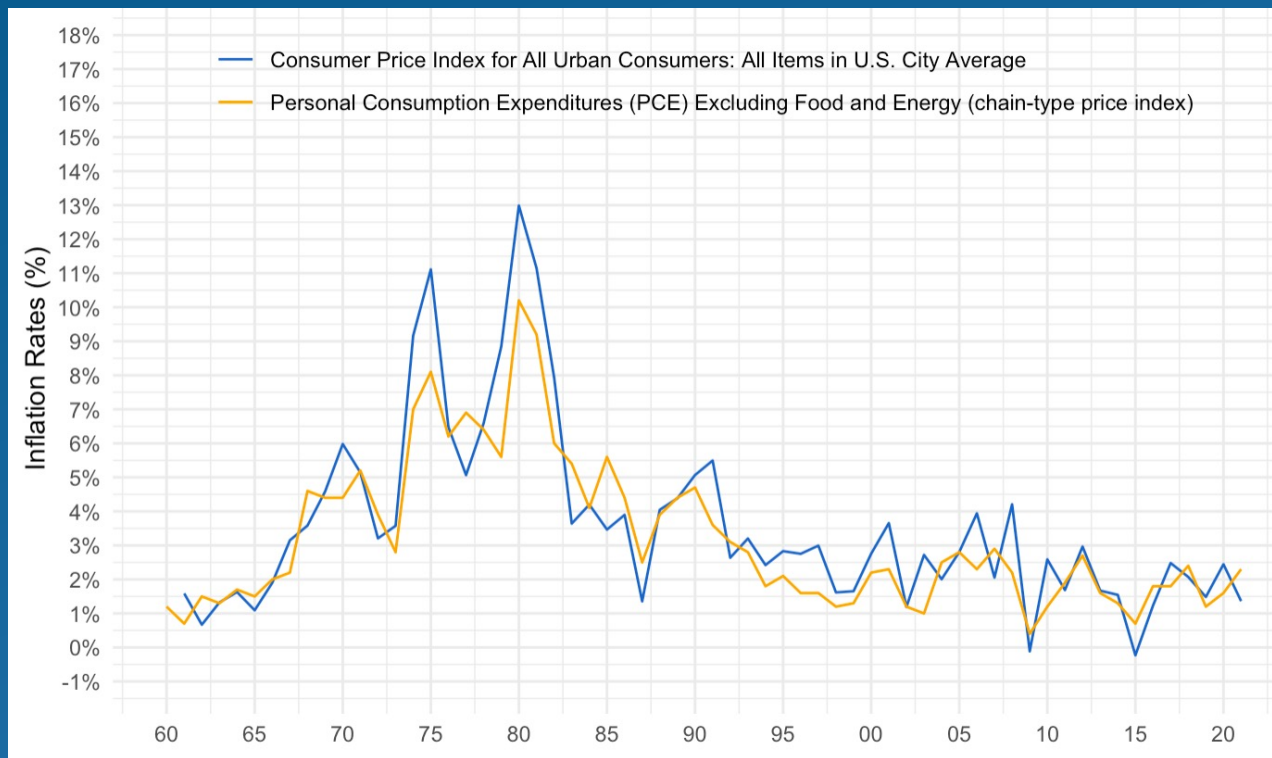
HICP = Not that harmonized in Europe (Housing)



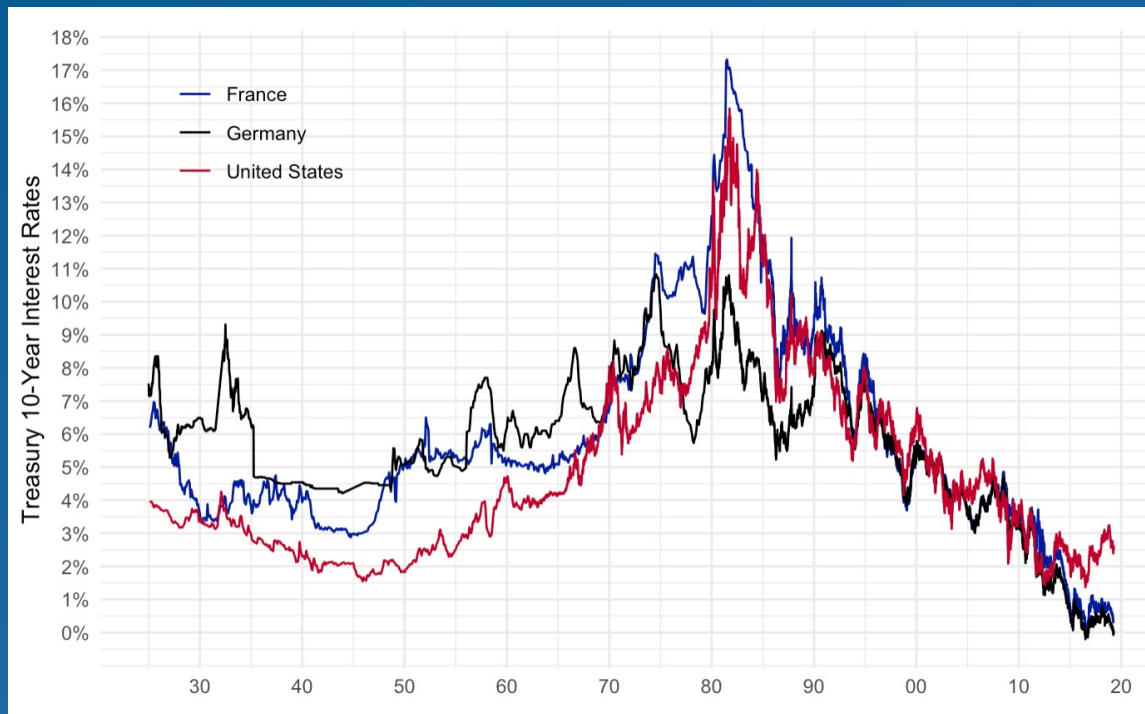
Heterogeneous: Balassa-Samuelson.



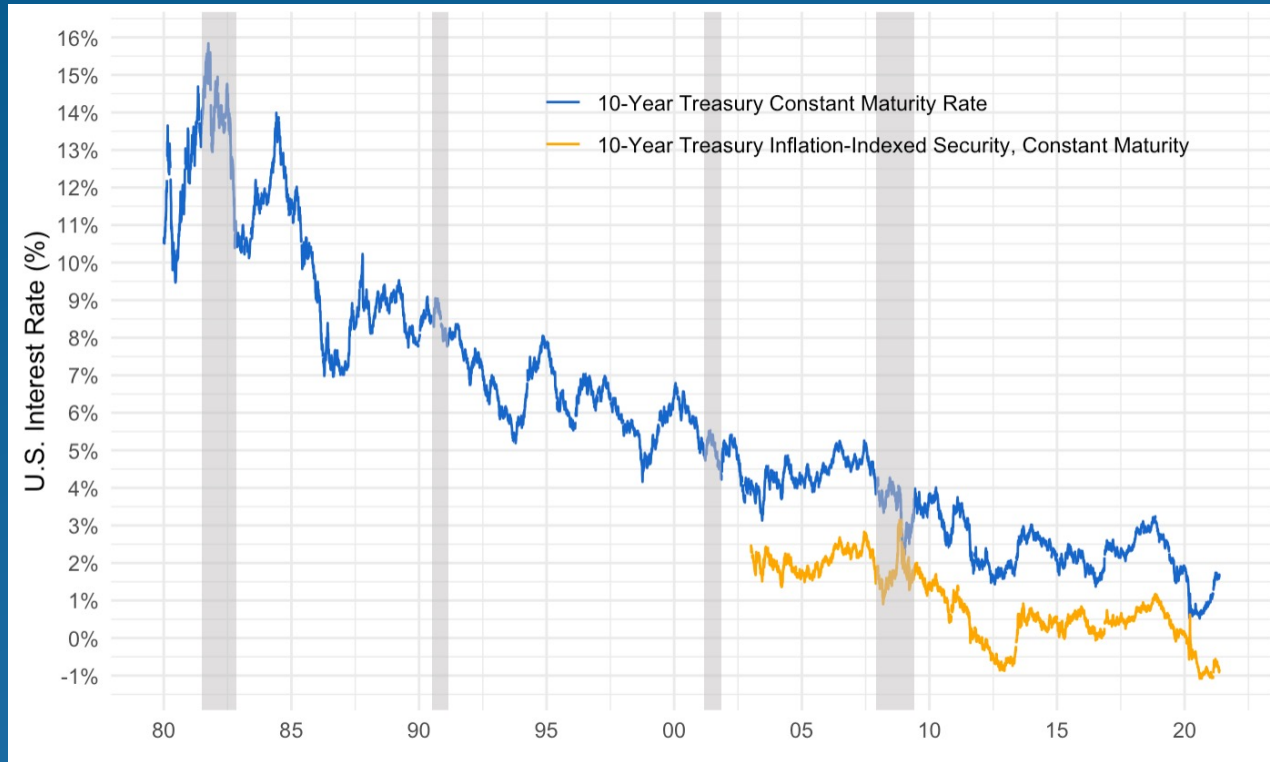
Example: U.S. Inflation



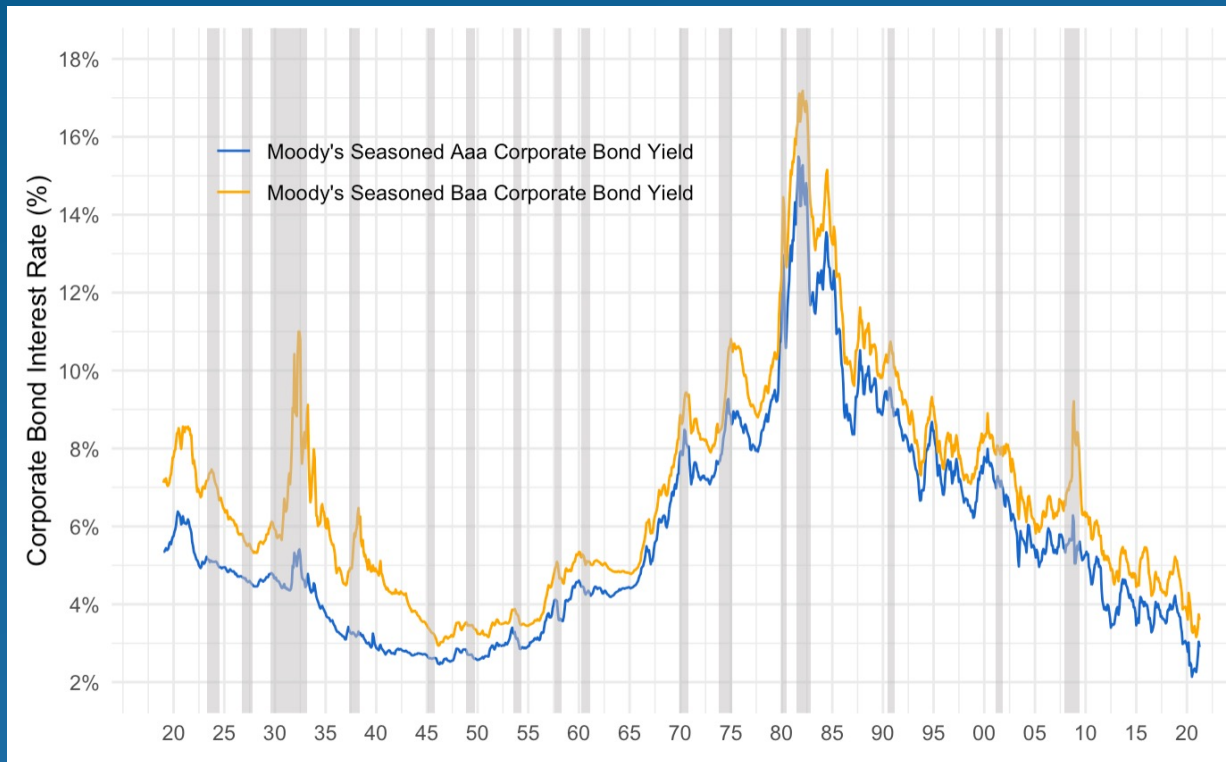
10-Year Treasury Rates since 1920



Nominal VS real (inflation-indexed) yields



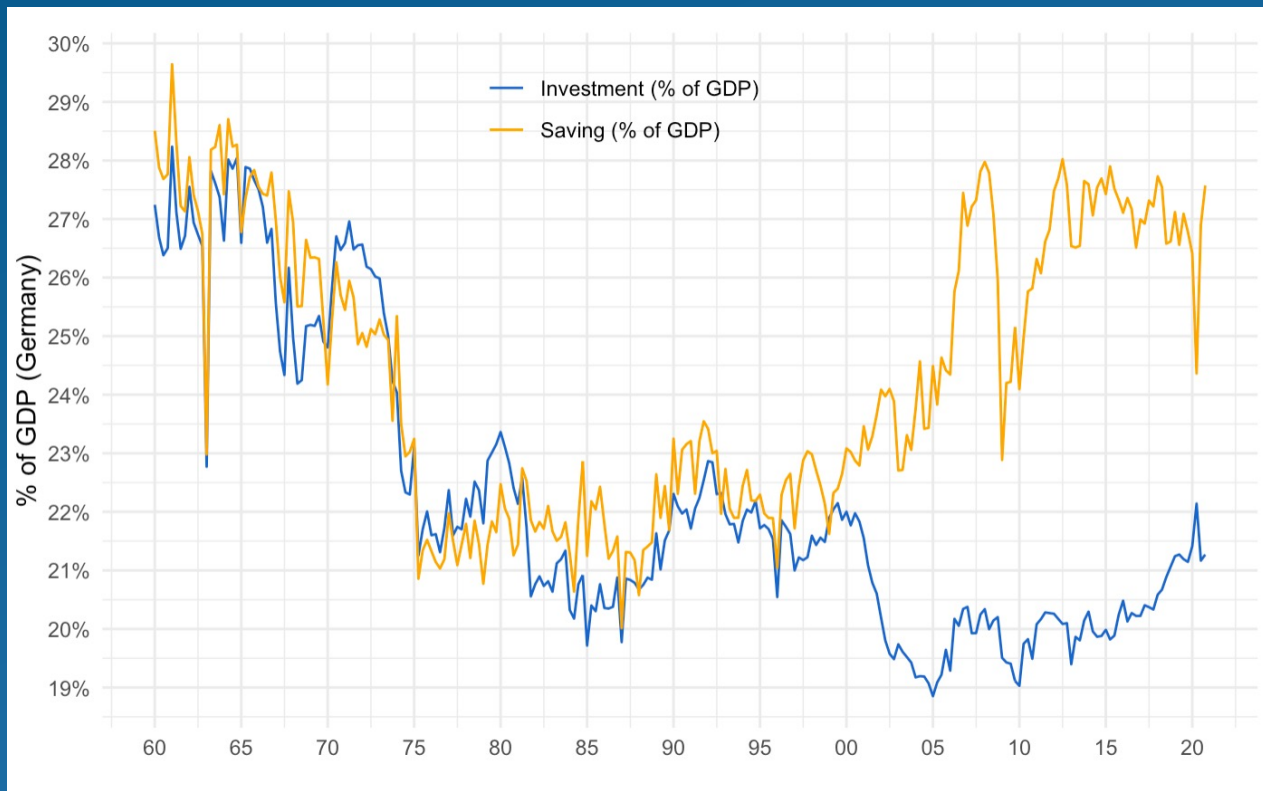
Corporate Bonds



Fall in real rates: what are the key drivers ?

- Real interest rates = market-clearing prices => Excess of savings supply over investment demand: “savings glut” or “secular stagnation”.
- ↗ in savings **supply**:
 - Demographic changes & **pension reforms** taken in response.
 - ↗ Income Inequality.
 - Fiscal: ↗ Consumption taxes, ↘ profit / capital taxes.
 - ↗ Mercantilist trade tactics (China, Germany (?)).
 - ↗ Precautionary saving after East Asia financial crisis.
- ↘ in investment **demand**:
 - ↘ population growth (Hansen).
 - ↘ capital intensity of new technologies (GAFA vs. manufacturing).

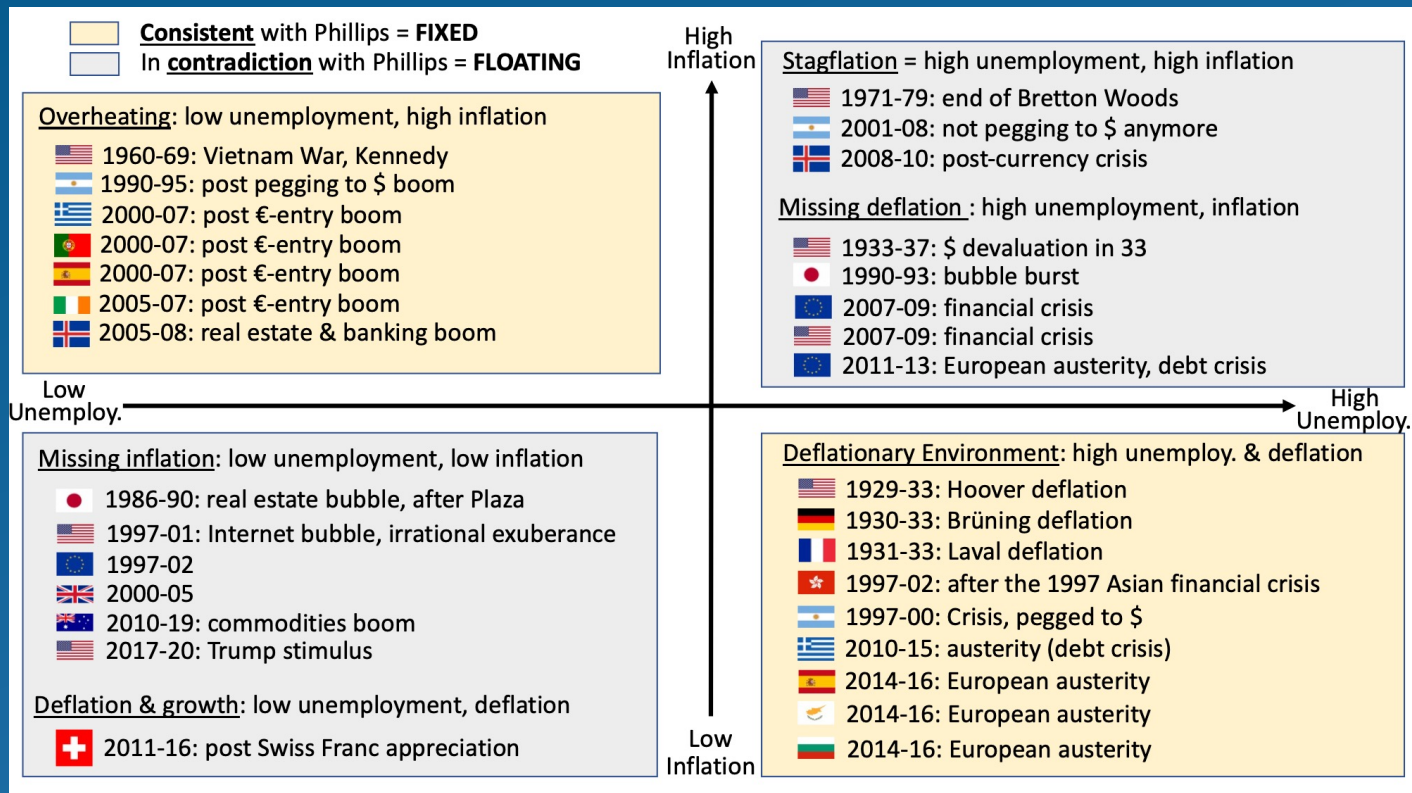
Germany. Too fast S-I. Riester + Fiscal Reforms.



Fall in inflation: what are the drivers ?

- Do we know what determines world inflation ?
- **Key factors** : globalization (e.g. toys), entering of China in WTO with high productivity growth, etc.
- **Phillips curve** reasoning:
 - Savings glut, low aggregate demand $\Rightarrow$ low inflation.
 - Massive Biden stimulus $\Rightarrow$ opposite direction $\Rightarrow$ overheating ?
- But, reasons to be skeptical of the Phillips curve:
 - 2007-09: no deflation (not even disinflation) despite world recession, driven by deleveraging (fall in demand). Remains a puzzle.
 - Historically Phillips curves have been observed under **fixed** exchange rates, **not floating** rates $\Rightarrow$ real exchange rates, not inflation ?
- At least we should be cautious $\Rightarrow$ Do we know what determines world inflation ? Most probably not slack.

Hard to see a Phillips curve under floating ? (grey)



Key debates: what's next ?

- Real rates = what is the relative importance of **fundamentals** - excess savings VS investment imbalances - vs. monetary **policy**?
- Note: monetary policy is trying to respond to low aggregate demand / low inflation, so the two are not independent.
- When has secular stagnation / savings glut started ? 1970s (Petrodollars) ? 1990s ? (banking crises) 2010s ? (negative rates)
- Low interest rates lead to “too much” risk taking, **bubbles** (like cryptos), chasing for yield in particular ?
 - How much is due to monetary policy itself ?
 - How much is the result of too much money chasing too few assets ? (secular stagnation)
- Will the Joe Biden's fiscal policy change this ? Will U.S. public debt “soak up” savings ? What about Europe ? (e.g. Germany ?)

Key debates

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Thank You