

FISCAL POLICY AND INFLATION

Fernanda Nechio

Federal Reserve Bank of San Francisco

Fiscal Policy and Sovereign Debt

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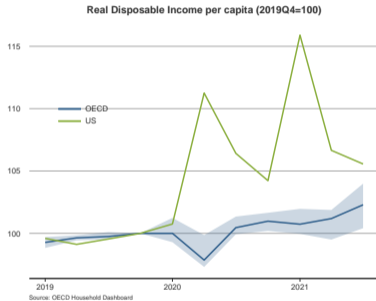
Slides based on findings from Carvalho, Ferrero, Mazin and Nechio (2024), Carvalho and Nechio (2023), Jordà and Nechio (2023).

The views expressed herein are solely the responsibility of the authors and should not be interpreted as reflecting the views of the Federal

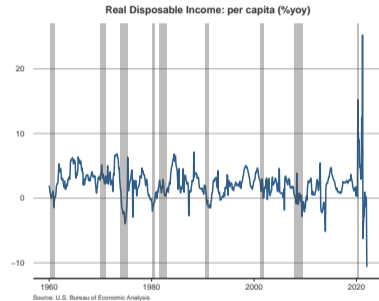
Reserve Bank of San Francisco or the Board of Governors of the Federal Reserve System.

Covid policy responses and inflation

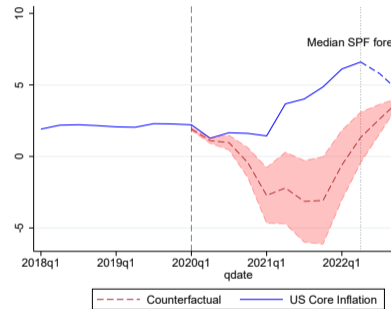
U.S. vs OECD



U.S. historically



Price inflation



Source: Jordà and Nechio (2023), "Inflation and Wage Growth Since the Pandemic," European Economic Review.

Stronger correlation between expected inflation and debt since fiscal woes

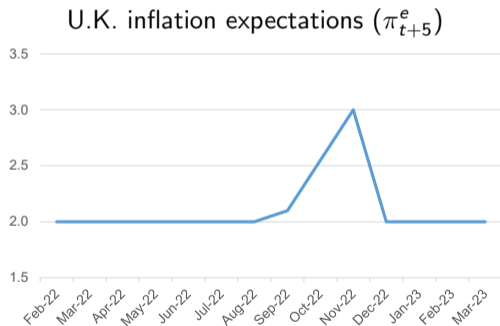
Correlations between inflation and gross debt projections

	$\rho(\pi_{t+2,3}^e - \pi_{t+2,3}^*, D_{t+5} - D_{t+1})$		$\rho(\pi_{t+2,3}^e - \pi_{t+2,3}^*, D_{t+8} - D_{t+1})$	
	Level	Δ 30-day	Level	Δ 30-day
Pre-unanch. (01/22/2018 - 08/31/2021)	0.4***	0.03	0.28***	0.09*
Since unanch. (09/01/2021 - 01/20/2023)	0.68***	0.33***	0.74***	0.27***
Since 1 st round (10/03/2022 - 01/20/2023)	0.76***	0.59***	0.72***	0.3*

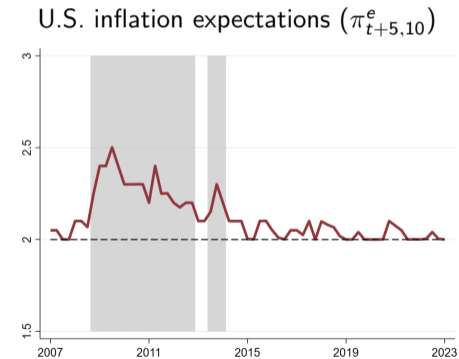
- Since 2018, professionals survey projections for debt/GDP path
- Correlations between $(\pi_{t+2,3}^e - \pi_{t+2,3}^*)$ and $(D_{t+h} - D_{t+1})$, $h = \{5, 8\}$
 - Sharp increase in correlations since expectations unanchored
 - Additional step-up close to Oct. 2022 election
 - These held despite BCB's contractionary stance and inflation declining sharply

Credibility can be challenged in advanced economies

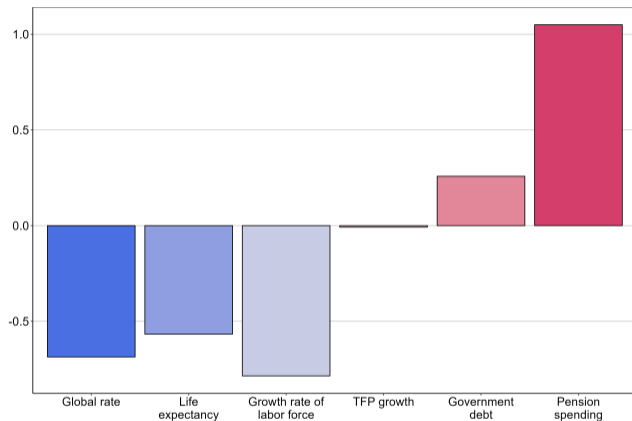
- U.K. long-term expectations rose and fell following fiscal announcements
- Reported concerns about fiscal



- U.S. expectations rose after GFC
- But remained well anchored since the pandemic



Fiscal spending and r-star



- Estimates from ECM on panel of OECD economies from 1979-2019
- Interaction of variables with degree of financial openness
- Global factors summarized by a global real rate variable

Source: Carvalho, Ferrero, Mazin and Nechio (2024), "Demographics and Real Interest Rates across Countries and over Time."