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High Inflation and Monetary Policy

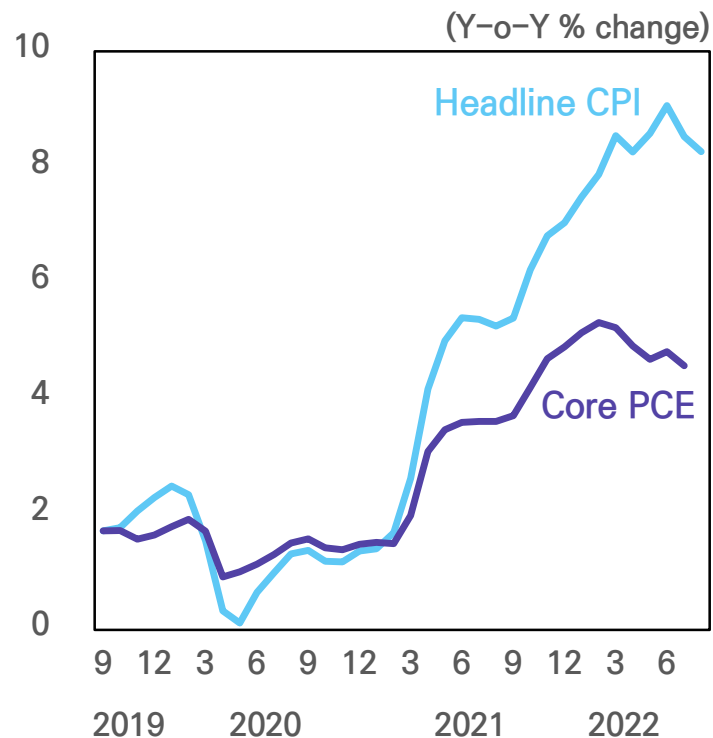
Kyu-Chul Jung

Sep. 21, 2022

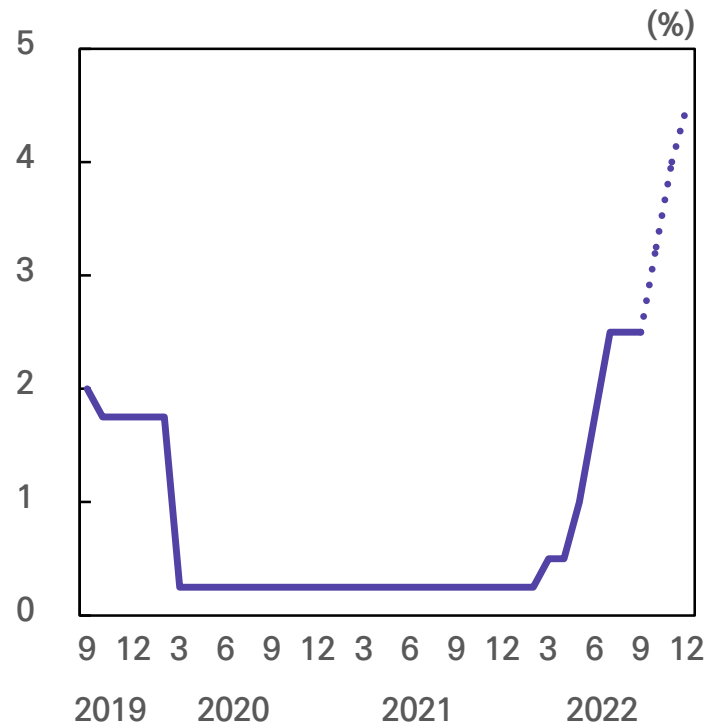
3-Highs

High inflations, high interest rates, and high exchange rates.

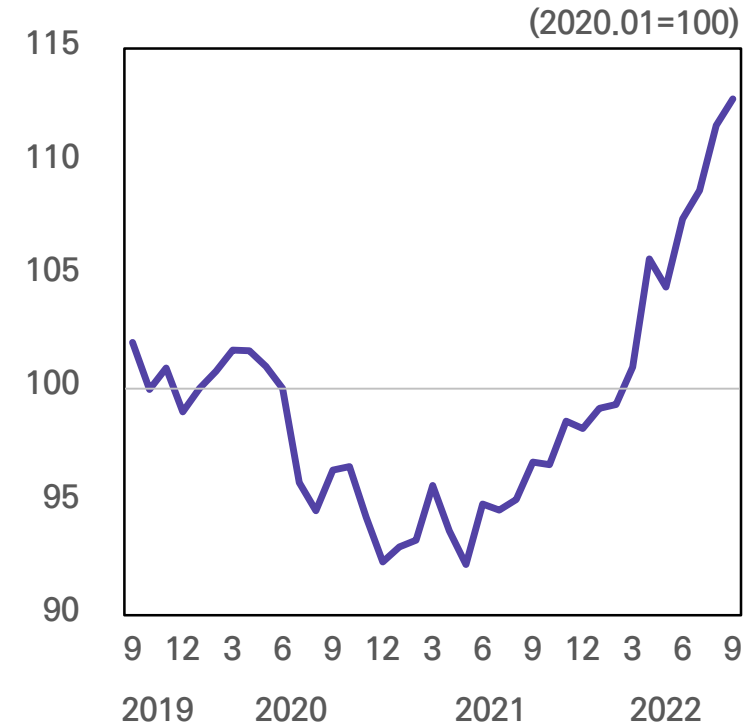
US Inflations



US Federal Funds Rate



Dollar Index (See Engel's discussion)

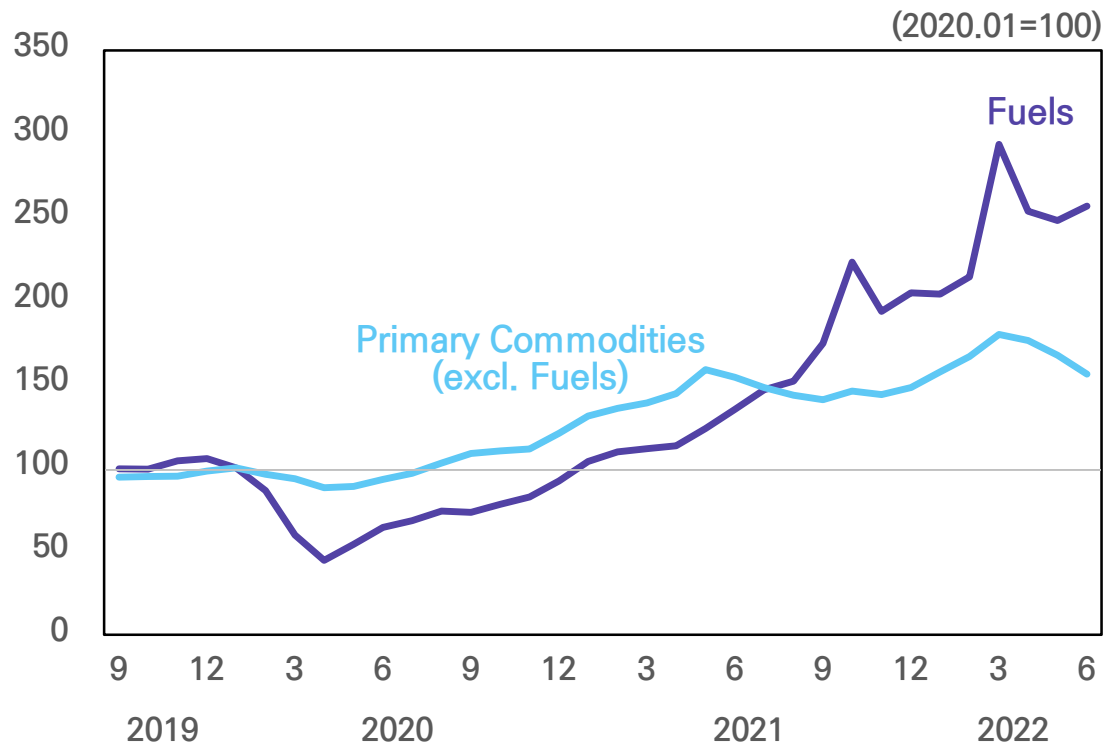


Source: Bloomberg, Bureau of Economic Analysis, Bureau of Labor Statistics, CME Group.

Factor 1: High Uncertainty of Supply Shock Persistence

The recent supply shock displays higher persistence than usual, and its future trajectory is hard to identify and predict, making it difficult to introduce proper policy measures.

Commodity Prices

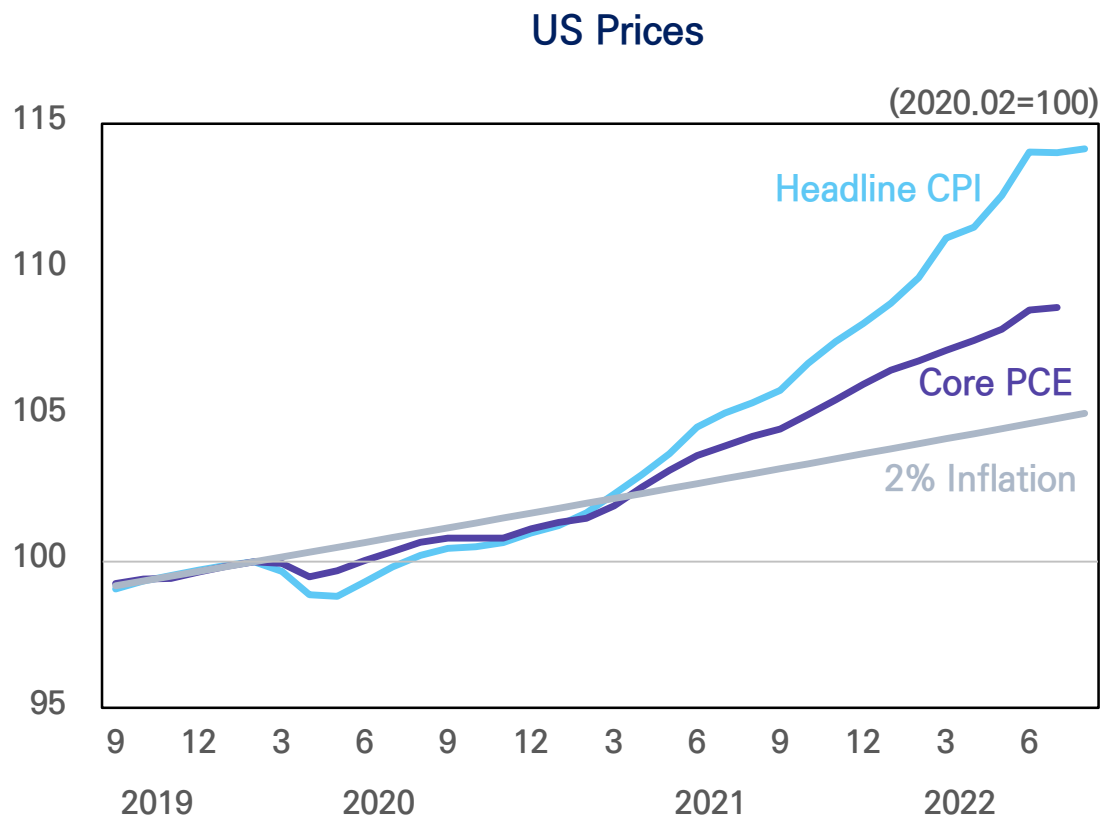


Source: CPB.

- ✓ The nature of the supply shock may have changed.
- ✓ Commodity prices stay elevated on the unpredictable and protracted war in Ukraine.
- ✓ Still difficult to give a projection of when the supply shock will ease.

Factor 2: Trade-off between the Present and Future

During the pandemic-driven crisis, the central bank committed to QE and average inflation targeting at the cost of future high inflations for stability under the zero lower bound.

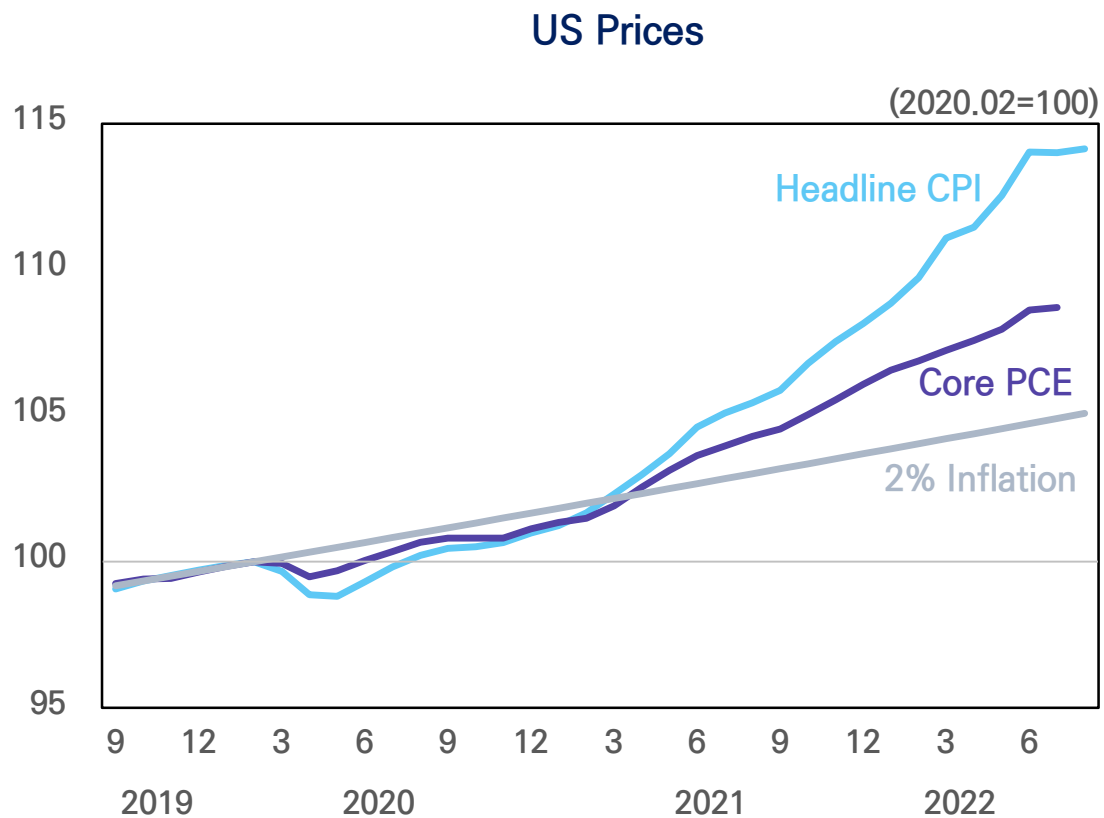


Source: Bureau of Economic Analysis, Bureau of Labor Statistics.

- ✓ Contributed to preventing severe deflation or financial collapse during the pandemic.
- ✓ What unfolds today is the price paid for the use of monetary interventions during the crisis.
- ✓ Another trade-off is seen in the ongoing effort for a stable mid-term inflation expectation at the cost of the current economic slowdown.

Factor 3: Policy Mistakes

Failed to commence preemptive and solid policy response against the earliest signs of rising inflation.

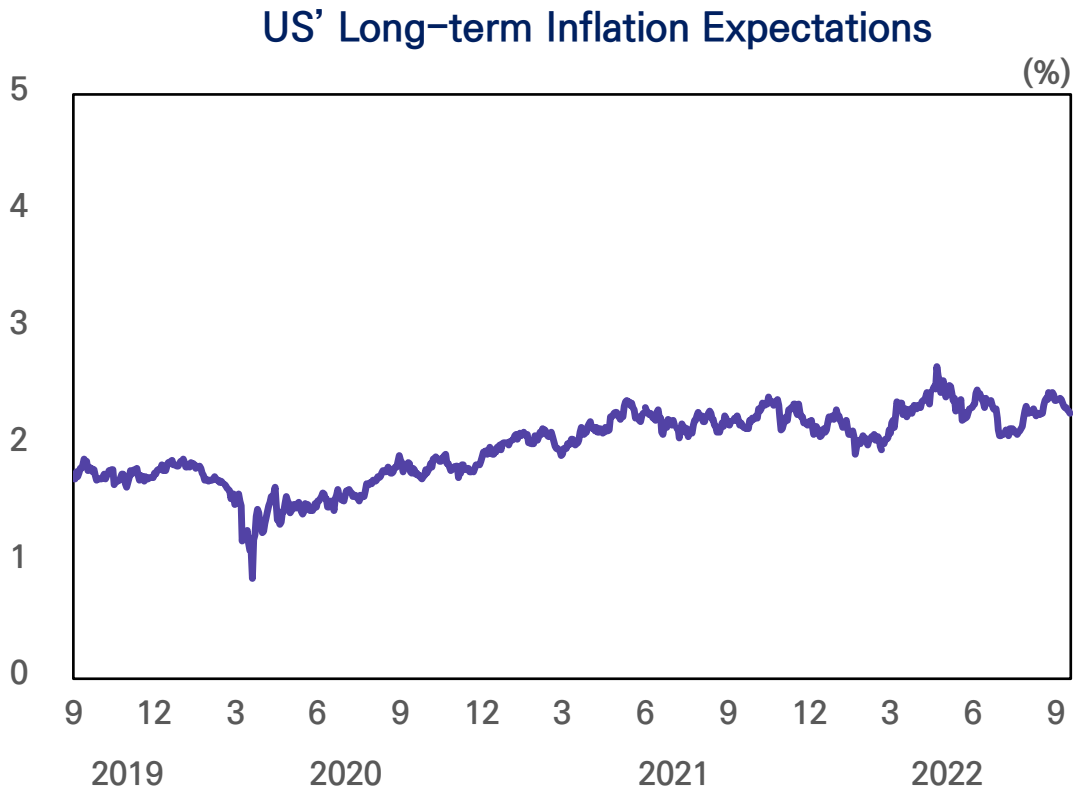


Source: Bureau of Economic Analysis, Bureau of Labor Statistics.

- ✓ Signs of creeping inflation since early 2021.
- ✓ Risk: A fool in the shower room.
- ✓ Average inflation targeting is still in use?

A New Era of Persistently High Inflations?

What are the implications of aging population, deglobalization, and climate change response on the long-term inflation trends?



Note: 5-year, 5-year forward inflation expectation rate.
Source: Federal Reserve Bank of St. Louis.

- ✓ Financial markets expect the inflation at around 2 percent 5 years later.
- ✓ The slowdown in long-term growth driven by supply factors leads to a fall in the real neutral interest rate (r^*).
- ✓ The zero lower bound problem may occur more frequently, leaving little room for policy responses against growing deflationary pressure, as during the COVID-19 crisis.
- ✓ Inflation may become more volatile.

Thank you.