Who Bears the Costs of Inflation: Euro Area Households and the 2021 Shock, by Filippo Pallotti, Gonzalo Paz-Pardo, Oreste Tristani, and Giovanni L. Violante

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Heterogeneous Agents in Macroeconomic Models, Prague

16-17 May 2024

Summary

- **A daunting task!**
- Welfare change caused by inflationary change broken down into interpretable components that can be estimated from micro and macro data without making additional assumptions.
- 4 components, possibly heterogeneous across HHs
  1. Direct (without fiscal and GE): cons. baskets, portfolios
  2. Unconventional fiscal policy: transfers, subsidies
  3. Indirect: response of all prices to shock
  4. Long-run adjustment: relative price realignment
- Estimates across age and income (not wealth)
- Very large effects, also very large heterogeneity across age brackets and countries

A paper where details are important

- **The paper does a lot**, and good understanding of micro-level data from several sources (HBS, HFCS, fiscal measures, HICP details...), as well as sectoral data is important to see what exactly was done, and to see that what was done is actually well thought-of and reasonable
- I'd include the figure with prices and price level in the paper (Jirka kindly sent me the figure that he will likely have on the slides), as it helps a lot in understanding the nature of the exercise considered (much clearer than the text in the paper)

Comment: OLG setting

Welfare is computed based on 2-generation OLG setting:

- Strong non-Ricardian features for fiscal policy analysis
- In addition, also very strong dependence on reversal of relative price shock (the "indirect effect" where the older generation "locks-in" the loss and the young generation benefits from the rebound).
- Only 10% are assumed to die, which attenuates the loss
- $\Rightarrow$ Suitable for welfare-analysis in a short-lived inflation episode?
- If the government gains (which it does), non-Ricardian features imply a gain for the young
- It may make sense to include a bequest motive and associated welfare with some expected recovery of prices

Open economy: Foreign is intra-EA or outside EA?

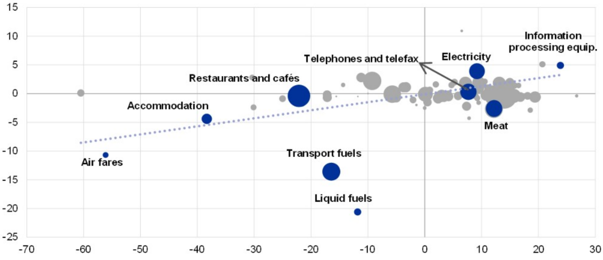
EA economies are open with considerable cross-country wealth (debt) stocks. Sections 5.2.3 and 5.2.4 seem quite important given:

- Cross-country differences are largely driven by energy, so a lot of it is (extra-EA) terms-of-trade shock
- In addition, post-covid fiscal policy in Europe involves intra-EA transfers of wealth (NGEU)
- Neither is within-country income distribution, but inter-country incomes (lost for the agents within the country)
- Is there a RER channel via valuation with different inflations in addition to ToT channel?
- Reconciliation of results from micro and flow-of-funds data (very nice "sanity check"!)
- Could Foreign's gain be attributed (e.g., is DE's Foreign's gain a gain of IT government?)

Weights updated (nice!) using *cumulative* inflation (Table 12: IT: 3.2 or 4.3 p.p. difference w.r.t. official). But do weights move only with prices (reversal of covid moves)? What if prices are regulated and/or subsidised?

Changes in HICP weights and inflation by granular spending categories

(x-axis: percentage change in HICP weights between 2020 and 2021; y-axis: change in annual inflation rates between January 2020 and January 2021)



Sources: Eurostat and authors' calculations.
Notes: The chart shows the correlation between the change in HICP weights (x-axis) and the change in the year-over-year HICP inflation rate (y-axis). Each bubble represents an HICP item at the COICOP-4 level of aggregation.

Source: Goncalves, Henkel, Kouvavas, Porqueddu and Tezzi (ECB EB 2/2021)

Minor things

- Wage negotiations may have agreed wage increases in the future (beyond the considered horizon) - you have this in the long-run component, but is it may not necessarily be full adjustment
- There may have been other benefits negotiated (hours reduction)
- Consistency: The grouping is sometimes said to be by income quintiles (Appendix D), sometimes by consumption quintiles (Sec. 3), sometimes by expenditure quintiles (Sec. 4)

Overall

- A very big piece of work, data-intensive, spanning a lot of fields conceptually and data-wise
- A lot of detail in the paper, and many things have been carefully thought over (which may be underappreciated)
- If the results are robust, it seems very worrying for a monetary union if there are so large differences in welfare after a *common* shock (An argument for more solidarity / fiscal union?)