Discussion of
'The Missing Internal Devaluation'
Giancarlo Corsetti, Luca Dedola, Riccardo Trezzi

Giovanni Ricco

University of Warwick and OFCE–SciencesPo

Housing, Housing Credit, and the Macroeconomy Conference
London, 15 September 2017

The Missing Internal Devaluation

- Internal devaluation – rebalancing mechanism in currency area
- (labour mobility and fiscal transfers)
- Price, wages and employment responses to **asymmetric demand (house prices) shocks** across US Metropolitan Statistical Areas (MSAs)

$$\text{House Prices Shocks} \Longrightarrow \begin{cases} \text{Wealth Effect} \\ \text{Borrowing Constr.} \end{cases} \Longrightarrow \dots$$

$$\Longrightarrow \text{Local Demand} \Longrightarrow \begin{cases} \text{Prices} \\ \text{Wages} \\ \text{Employment} \\ \text{...} \end{cases}$$

The Missing Internal Devaluation

- Internal devaluation – rebalancing mechanism in currency area
- (labour mobility and fiscal transfers)
- Price, wages and employment responses to **asymmetric demand (house prices) shocks** across US Metropolitan Statistical Areas (MSAs)

$$\text{House Prices Shocks} \Longrightarrow \begin{cases} \text{Wealth Effect} \\ \text{Borrowing Constr.} \end{cases} \Longrightarrow \dots$$

$$\Longrightarrow \text{Local Demand} \Longrightarrow \begin{cases} \text{Prices} \\ \text{Wages} \\ \text{Employment} \\ \text{...} \end{cases}$$

- **Differential effect on traded/non-traded** (goods/services) sectors

This Paper

- **Multi-country NK model** tradable/non-tradable
- **Panel data IV regression**

$$\Delta y_{i,t} = \kappa_i + \tau_t + \beta \Delta hp_{i,t} + \theta X_{i,t} + \varepsilon_{i,t}$$

- Cumulative inflation 2008-2011
- BAE Regional Parity Dataset for 266 MSAs
- Identification from cross-sectional variation in house prices
- IV regression, housing supply elasticity as instrument (Saiz, 2010)

This Paper

Key Results:

- relative price of goods falls (not significantly)
- relative price of services rises (significantly)
- no adjustment in wages (manufacturing/services/distribution)
- no responses in markups (labour shares)

This Paper

Key Results:

- relative price of goods falls (not significantly)
- relative price of services rises (significantly)
- no adjustment in wages (manufacturing/services/distribution)
- no responses in markups (labour shares)

(1) **Lack of connection between the slack** and wage **and prices** during the Great Recession (not only over time but also) **across US locations**

(2) **Puzzling** result for **services**!

Comment 1

Important question....

Comment 1

Important question....

Europa, de te fabula narratur

Comment 1

Important question....

Europa, de te fabula narratur

Thoughtful paper!

Comment 2: Related Literature

Mian and Sufi (2014)

- Job losses in the non-tradable sector
- No correlation with tradable sector
- No response of wages
- Little evidence of labour mobility

Comment 2: Related Literature

Mian and Sufi (2014)

- Job losses in the non-tradable sector ✓
- No correlation with tradable sector ✓
- No response of wages ✓
- Little evidence of labour mobility ✓

Comment 2: Related Literature

Mian and Sufi (2014)

- Job losses in the non-tradable sector ✓
- No correlation with tradable sector ✓
- No response of wages ✓
- Little evidence of labour mobility ✓

Stroebel and Vavra (2016)

- Local retail prices (of tradable good) respond to house-price-induced local demand shocks
- … via an increase in markups

Comment 2: Related Literature

Mian and Sufi (2014)

- Job losses in the non-tradable sector ✓
- No correlation with tradable sector ✓
- No response of wages ✓
- Little evidence of labour mobility ✓

Stroebel and Vavra (2016)

- Local retail prices (of tradable good) respond to house-price-induced local demand shocks ✗
- ... via an increase in markups ✗

What does explain the differences?

Comment 2: Related Literature

Mian and Sufi (2014)

- Job losses in the non-tradable sector ✓
- No correlation with tradable sector ✓
- No response of wages ✓
- Little evidence of labour mobility ✓

Stroebel and Vavra (2016)

- Local retail prices (of tradable good) respond to house-price-induced local demand shocks ✗
- ... via an increase in markups ✗

What does explain the differences?

- General vs partial equilibrium?
- Noise in macro data or coarse aggregation?
- ...

Comment 3: Local PCs in Currency Area

- Is a **multi-country trade model** the right one?
  - Movements of population?
  - Fiscal transfers?

Comment 3: Local PCs in Currency Area

- Is a **multi-country trade model** the right one?
  - ~~Movements of population?~~
  - Fiscal transfers?

Comment 3: Local PCs in Currency Area

- Is a **multi-country trade model** the right one?
  - ~~Movements of population?~~
  - Fiscal transfers?
- Are there **other channels?**
  - Are commercial properties a production input? (in services?)
  - Is the cost of housing services (living costs) affecting wages?

Comment 3: Local PCs in Currency Area

- Is a **multi-country trade model** the right one?
  - ~~Movements of population?~~
  - Fiscal transfers?
- Are there **other channels?**
  - Are commercial properties a production input? (in services?)
  - ~~Is the cost of housing services (living costs) affecting wages?~~

Comment 4: The Instrument

Supply shocks?

- Shock to firms' collaterals hence borrowing constraint
- ... higher marginal costs but no reason to correlate with tradable/non-tradable
- Shock to real estate values/commercial properties rent

Comment 4: The Instrument

The Telegraph

Home Video **News** World Sport Business Money Comment Culture Travel Life Wo

Politics | Investigations | Obits | Education | Science | Earth | Weather | Health | Royal | Celebrity

HOME » NEWS » UK NEWS

Café owner leaves brilliant response to one-star TripAdvisor complaint about £2 lemon water

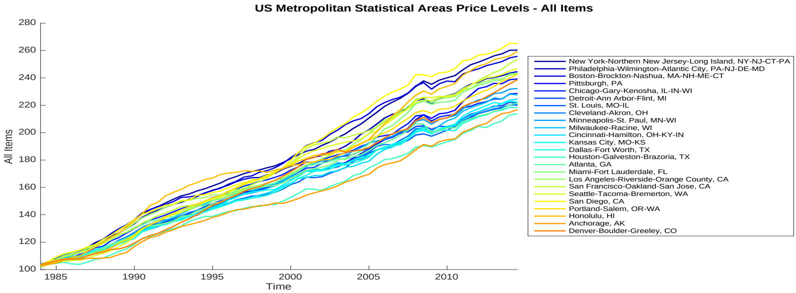
A customer left a negative review for Bennett's Café and Bistro on TripAdvisor when she was charged £2 for hot water with a slice of lemon

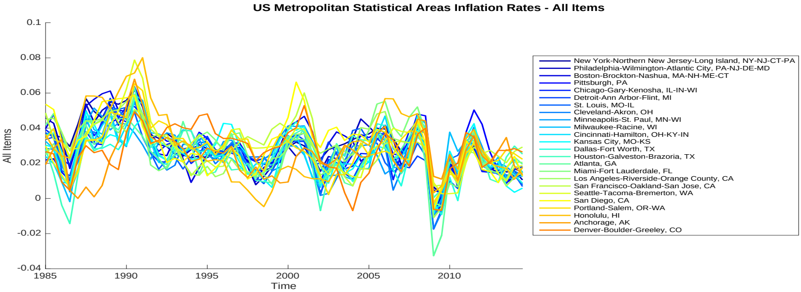
Comment 4: The Instrument

Supply shock?

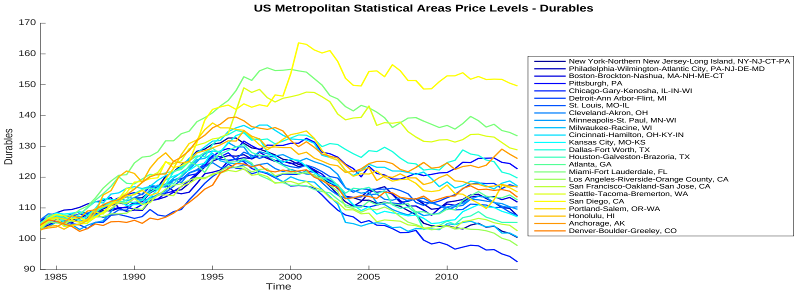
- Shock to firms' collaterals hence borrowing constraint
- ... higher marginal costs but no reason to correlate with tradable/non-tradable
- Shock to real estate values/commercial properties rent
- ... would depress prices above and beyond demand

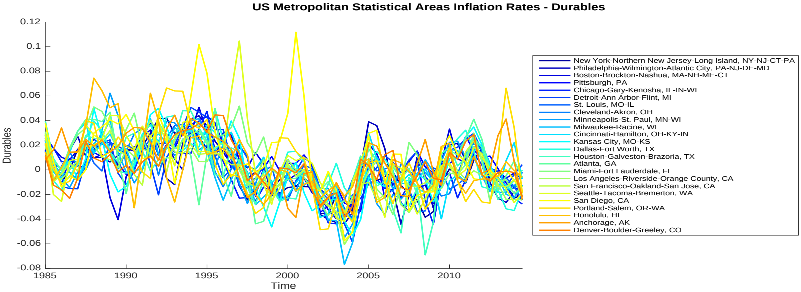
Comment 5: Trends (All Items)



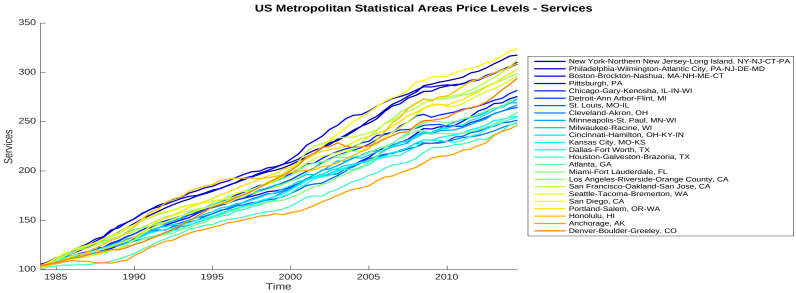


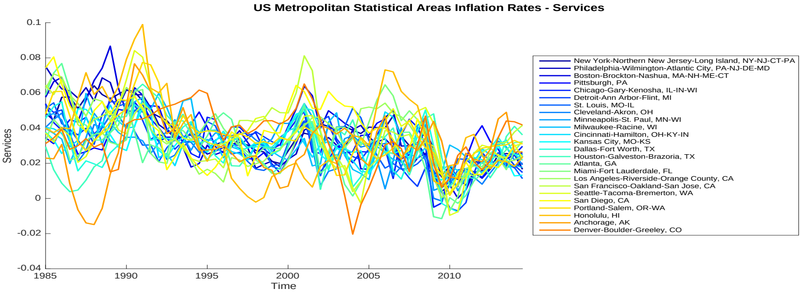
Comment 5: Trends (Durables)





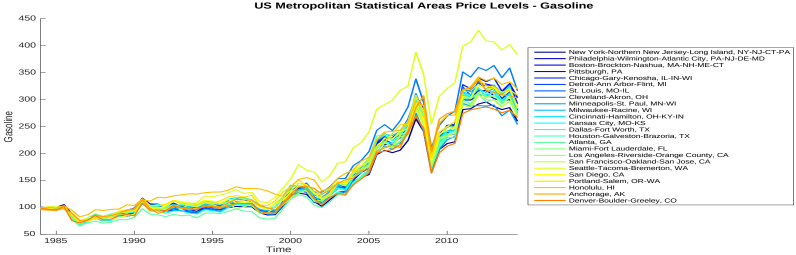
Comment 5: Local Price Dynamics – Services

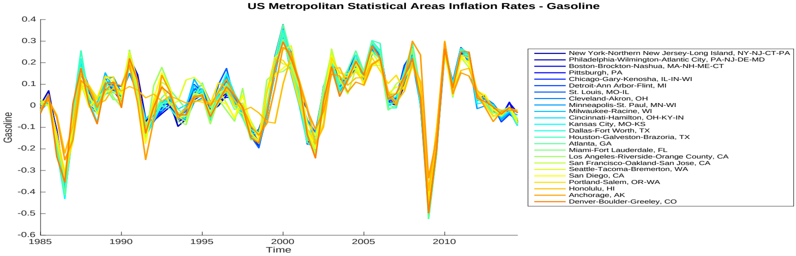




Comment 6: Energy Prices

Coibion and Gorodinichenko (2016)





Comment 7: The PCs is hard to spot!

> "Inflation is characterized by an underlying trend that has been essentially constant since the mid-1990s; .... Theory and evidence suggest that this **trend is strongly influenced by inflation expectations** that, in turn, depend on monetary policy. In particular, the remarkable stability of various measures of expected inflation in recent years presumably represents the fruits of the Federal Reserve's sustained effort since the early 1980s to bring down and stabilize inflation at a low level. The anchoring of inflation expectations ...does not, however, prevent actual inflation from fluctuating from year to year in response to the **temporary influence of movements in energy prices and other disturbances**. In addition, inflation will tend to run above or below its underlying trend to the extent that **resource utilization–which may serve as an indicator of firms' marginal costs**–is persistently high or low."
>
> — Janet Yellen, 60th Boston Fed Conference

Comment 8: The PCs is hard to spot!

Hasenzagl et al (2017)

$$\begin{pmatrix} u_t \\ y_t \\ oil_t \\ uom_t\{\pi\} \\ spf_t\{\pi\} \\ \pi_t \end{pmatrix} = \begin{pmatrix} \delta u & \gamma u & \phi u \\ \delta_y & \gamma y & \phi y \\ \delta oil & \gamma oil & \phi oil \\ \delta_{uom} & \gamma_{uom} & \phi_{uom} \\ \delta_{spf} & \gamma_{spf} & \phi_{spf} \\ \delta_\pi & \gamma_\pi & \phi_\pi \end{pmatrix} \begin{pmatrix} \psi_t^{(PC)} \\ \psi_t^{(EP)} \\ \tau_t \end{pmatrix} + \begin{pmatrix} u_t^{(\psi_i)} \\ y_t^{(\psi_i)} \\ oil_t^{(\psi_i)} \\ uom_t^{(\psi_i)} \\ spf_t^{(\psi_i)} \\ \pi_t^{(\psi_i)} \end{pmatrix} + \begin{pmatrix} u_t^{(\tau_i)} \\ y_t^{(\tau_i)} \\ oil_t^{(\tau_i)} \\ uom_t^{(\tau_i)} \\ spf_t^{(\tau_i)} \\ 0 \end{pmatrix}$$

Comment 8: The PCs is hard to spot!

Hasenzagl et al (2017)

$$\begin{pmatrix} u_t \\ y_t \\ oil_t \\ uom_t\{\pi\} \\ spf_t\{\pi\} \\ \pi_t \end{pmatrix} = \begin{pmatrix} 1 & 0 & 0 \\ \delta_y & 0 & 0 \\ 0 & 1 & 0 \\ \delta_{uom} & \gamma_{uom} & \phi_{uom} \\ \delta_{spf} & \gamma_{spf} & \phi_{spf} \\ \delta_\pi & \gamma_\pi & \phi_\pi \end{pmatrix} \begin{pmatrix} \psi_t^{(PC)} \\ \psi_t^{(EP)} \\ \tau_t \end{pmatrix} + \begin{pmatrix} u_t^{(\psi_i)} \\ y_t^{(\psi_i)} \\ oil_t^{(\psi_i)} \\ uom_t^{(\psi_i)} \\ spf_t^{(\psi_i)} \\ \pi_t^{(\psi_i)} \end{pmatrix} + \begin{pmatrix} u_t^{(\tau_i)} \\ y_t^{(\tau_i)} \\ oil_t^{(\tau_i)} \\ uom_t^{(\tau_i)} \\ spf_t^{(\tau_i)} \\ 0 \end{pmatrix}$$

- ϕ_{uom}, ϕ_{spf}, and ϕ_π are set to 1 over the standard deviation of the difference of the variable.
- The shocks to all unobserved components are orthogonal.

Comment 8: The PCs is hard to spot!

Hasenzagl et al (2017)