

Inflation dynamics with search and matching in the labour market

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1. Eurosystem research networks

- Value is nicely illustrated by this output
 - “Prequel”: overview of developing research area by some of its main contributors
 - What are the limits to organization of economists?
 - <5 based on housing in graduate school
 - ≤ 4 based on my own research experience
 - BU faculty meetings: “herding cats” (Bob Margo)
 - Yet, this seven author effort is a relatively polished paper with lots of useful information provided to an “outsider” to the emerging literature
 - And the Eurosystem research networks are functioning to provide valuable information on prices and wages

Networks cont'd: Design

- Inflation persistence network: “micro price dynamics network”
 - Interpret existing data on consumer and producer prices
 - Conduct new surveys
 - Increase accessibility of micro price data
 - Suggest new measurements
- Key point from pricing:
 - lots of heterogeneity, in magnitude and timing of adjustments across sectors and countries
 - Heterogeneity allows prospect of disciplining macro specifications (think Friedman on consumption)

WND job (cont'd)

- This paper is a theoretical investigation, but it suggests important measurements that need to be undertaken
- Micro data holds same prospect as in pricing – sectoral and regional differences may help us understand mechanisms

2. Inflation dynamics

- Background is familiar NK pricing setup implying

$$\pi_t = \beta E_t \pi_{t+1} + \kappa \log(mc_t) \quad [11]$$

$$\kappa = (1 - \xi)(1 - \beta\xi) / \xi$$

$$\log mc_t = \log(mw_t) - \log(mpn_t)$$

- Simple reference model:
marginal = average wage, constant marginal product implies that
 $\log(mc) = \log(w) - \log(mpn) = \log(w)$: current and expected future real wages matter for inflation.
Low inflation response to “aggregate demand” if current and expected future real wages are not too responsive to agg demand

3. Labor market

- Tobin and New Haven
 - Is it “good jobs” that are first order?
 - Does stock of unemployed workers matter for employment and wage dynamics?
 - Or are most individuals willing to move in and out of market work (from other activities) at the right terms?
- Recent integration of DMP vision of search and matching labor market is important because it lets us talk about unemployment
 - Mertz, Shimer, Hall into RBC model
 - Many into NK type model
- But it has yielded puzzles
- And it is not yet clear to me that search and matching is first order in terms of understanding dynamics of inflation and/or business cycles

Decoupling the labor market

- My understanding is that matching unemployment volatility requires that wages are not responsive to unemployment (Hall)
- NK Channel:
 - Demand up, production and employment up, average markups down, inflation up
 - Markups to wages
 - Employment to unemployment

4. Sticky wages

- Early NK models went after sticky nominal prices and imperfect competition (summaries by Mankiw and Rotemberg circa 1986), rather than sticky nominal wages, because
 - they did not want to generate countercyclical real wage movements in response to nominal shocks (contrast Fischer)
 - accepted some version and to varying degrees the Barro-Hall critique Fischerian model: nominal stickiness is not necessarily allocative

Policy with sticky (real, nominal) wages

- It matters a lot how these are added, in terms of the
 - Positive implications
 - Optimal policy implications:
 - conventional wisdom challenged to varying degrees by Henderson/Erceg/Levin (no search) and Krause-Lubik (search)
 - conventional in Blanchard-Gali

of modern macroeconomic models

Gang of 7

- Explore battery of wage formation mechanisms and allocation rules
- Find that positive implications differ a lot depending on labor market details
 - New hire versus existing worker wage adjustments
 - Bargaining over wages and hours (shades of Barro) or just wages (shades of Fischer)
 - Nature of employment adjustment costs
 - Nature of search activity
 - Character of job destruction

Gang of 7 cont'd

- Critical bottom line: “Our results suggest that the extent to which the labour market matters for inflation dynamics depends critically on its microeconomic structure”
- “It would therefore be interesting to put the mechanisms that we (G7) have explored to a test from a micro-economic perspective”
- This illustrates the benefit of combining micro and macro elements, also making sure that there is a broad netible, WDN must be LabourMarketDynamicsNetwork
- And an important measurement topic is direct firm level information on interaction of pricing and wage determination: this is the link that it as the heart of this paper.