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The Inflation Rate Disconnect Puzzle: On the International Component of Trend Inflation and the Flattening of the Phillips Curve

On the International Component of Trend Infl and the Flattening of the Phillips Curve

Guido Ascarì$^{1,3,4,5}$ and Luca Fosso$^{2,5}$

$^1$Centre For Macroeconomics, $^2$Norges Bank, $^3$RCEA, $^4$University of Oxford, $^5$University of Pavia

Since 2000 U.S. inflation has remained both below target and silent to domestic slack and monetary interventions. A trend-cycle VAR decomposition explores the role of globalisation in explaining the puzzling behaviour of inflation. The trend analysis shows that, starting from 90s, despite very well-anchored expectations, slow-moving imported “cost-push” factors induced deflationary pressure keeping trend inflation below target. The cycle block provides evidence in favour of the flattening of Phillips curve, mainly attributable to a weaker wage pass-through. The business cycle behaviour of inflation is determined by a shock originating abroad, which indeed generates the main bulk of volatility in the international prices of intermediate goods and is poorly connected to the domestic slack.