

LESSONS FROM HISTORY FOR SUCCESSFUL DISINFLATION



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Monetary and Financial History: Lessons
for the 21st Century
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I. MOTIVATION

Episodes of Attempted Monetary Disinflation in the U.S, 1946-2016

October 1947

August 1955

September 1958

December 1968

April 1974

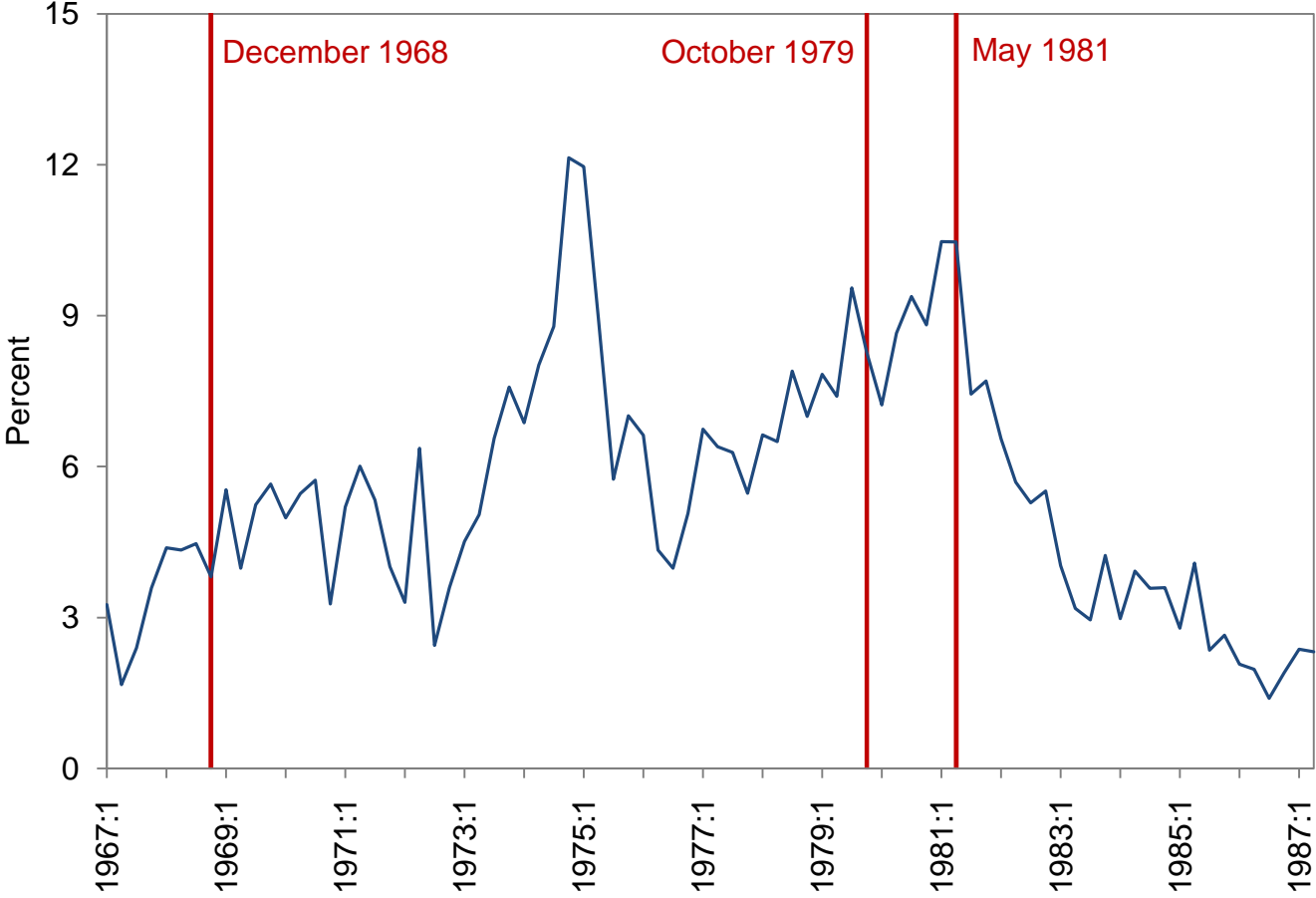
August 1978

October 1979

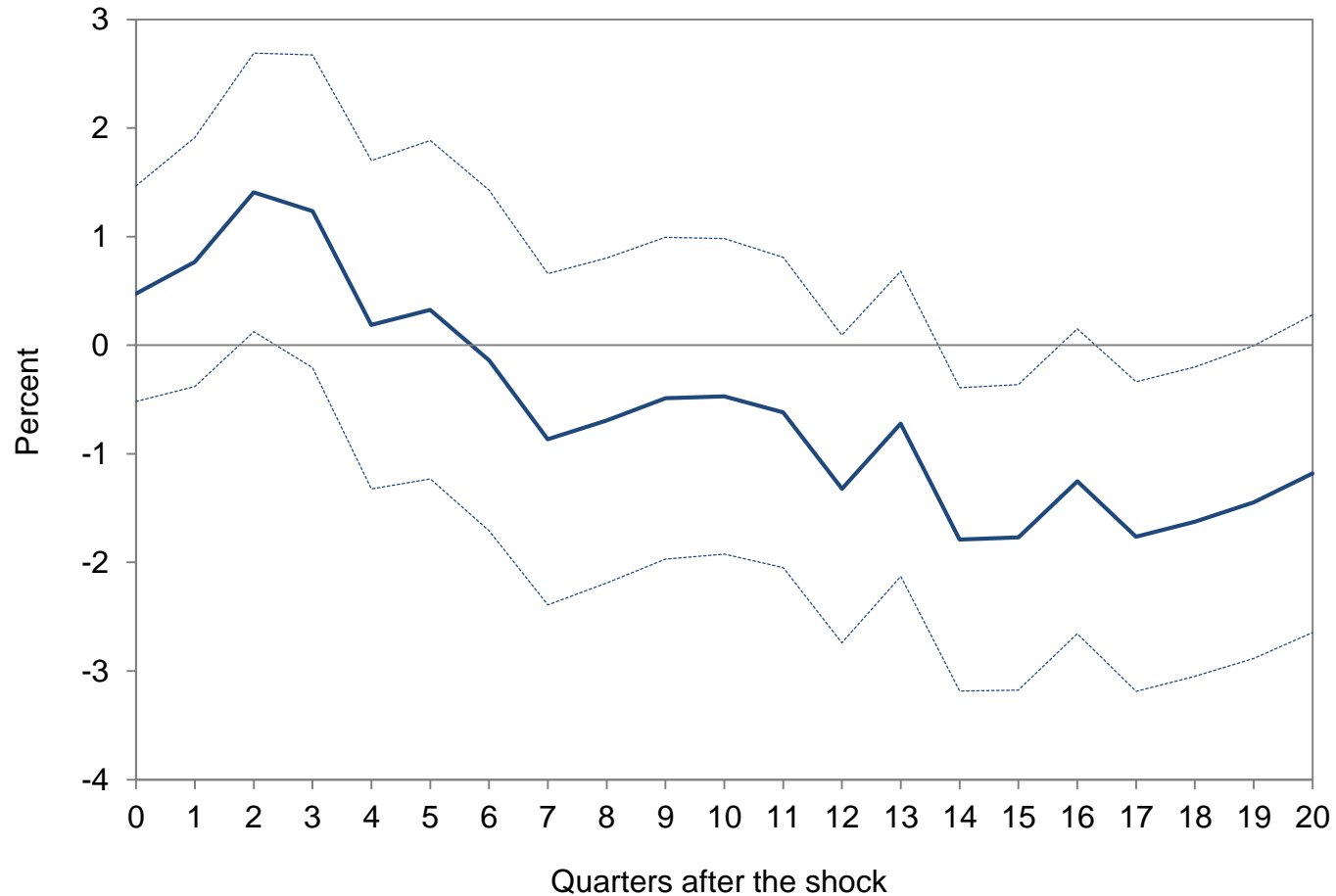
May 1981

December 1988

GDP Price Index Inflation, 1967Q1–1987Q1



Response of Inflation to an Attempted Disinflation



What makes some disinflations more successful than others?

- Hypothesis: Because policy is inherently dynamic, the ex ante commitment of policymakers to disinflation might be crucial.

II. HOW COMMITTED WERE MONETARY POLICYMAKERS IN DISINFLATIONARY EPISODES?

Criteria for Gauging Strength of Commitment at the Start of Episodes

- How large were the output costs policymakers were willing to bear?
- Did they think monetary policy could achieve disinflation essentially on its own?
- Did they have a clear inflation goal?
- Was it a “second try”?

Narrative Evidence on Commitment for May 1981

- “Through the course of recent history at least, we’ve backed off and we’ve made a mistake each time. **I think we have an opportunity this time to carry forward what we should have done before**” (Roger Guffy, *Transcript*, 7/6–7/1981, p. 55).
- “We have been put in a position or have taken the position ... that **we are going to do something about inflation maybe not regardless of the state of economic activity** but certainly more than we did before” (Paul Volcker, *Transcript*, 12/18–19/1980, p. 61).
- “**The Federal Reserve has an indispensable role to play in dealing with inflation.** To be effective, we must demonstrate that our own commitment is strong, visible, and sustained. That is our intention” (Volcker testimony, 3/27/1981, p. 10).

Narrative Evidence on Commitment for August 1978

- “It seems to me that there is at least a majority consensus within this group that inflation is a problem and that it would be desirable, if possible, to attempt to slow growth in the aggregates without causing a recession. **I think even the most maverick of us would be resistant to anything that would lead to recession**” (Lawrence Roos, *Transcript*, 9/19/1978, p. 31).
- “first, fiscal policy; second, incomes policy; third, reduction in regulatory burden; fourth, revitalization of productivity; fifth, a balance in our international accounts; **and sixth, a monetary policy which complements and supports the other elements**” (Miller speech, 12/12/1978, p. 3).
- “Inflation built up over twelve years; we are going to have to wring it out over five to seven years” (G. William Miller, *Transcript*, 10/17/1978, p. 23).

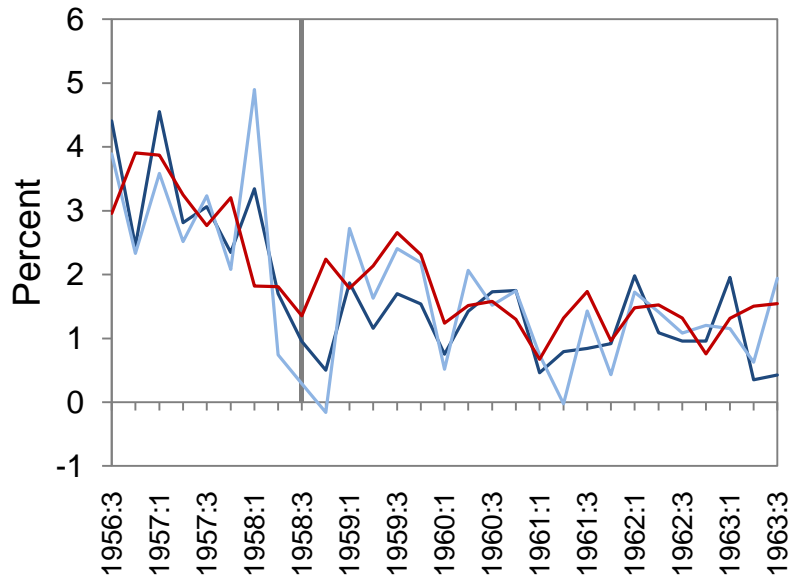
Disinflationary Monetary Policy Shocks Scaled by Commitment

Shock date	Commitment to disinflation	Scaled value (1 to 5)
October 1947	Medium (mixed)	3
August 1955	Medium	3
September 1958	High	5
December 1968	Low to medium	2
April 1974	Low to medium	2
August 1978	Low	1
October 1979	Medium to high	4
May 1981	High	5
December 1988	Medium	3

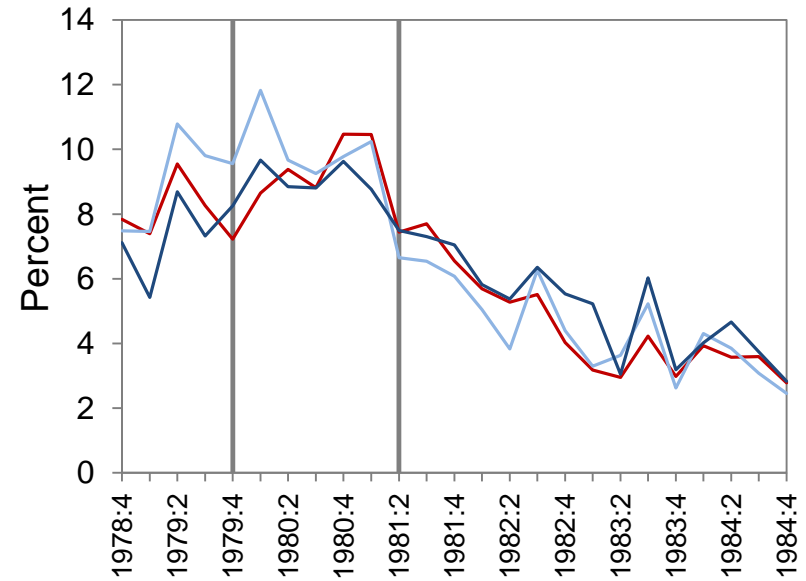
III. THE BEHAVIOR OF INFLATION IN DISINFLATIONARY EPISODES

Inflation Following High Commitment Shocks (Quarterly Changes at an Annual Rate)

1958Q3



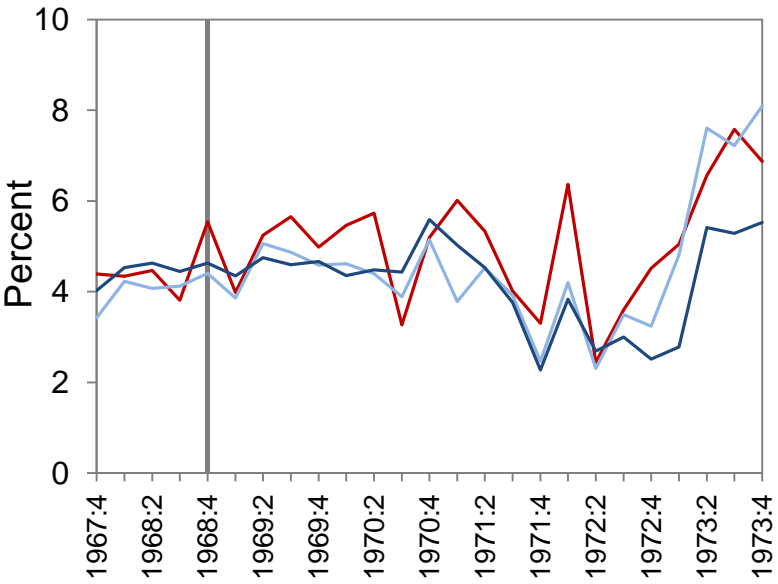
1979Q4 and 1981Q2



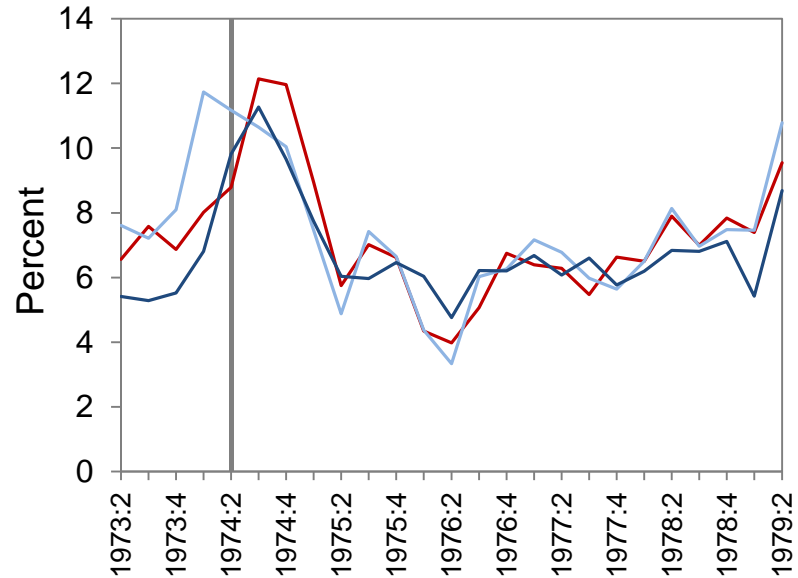
— Core PCE Price Index — PCE Price Index — GDP Price Index

Inflation Following Low Commitment Shocks (Quarterly Changes at an Annual Rate)

1968Q4



1974Q2

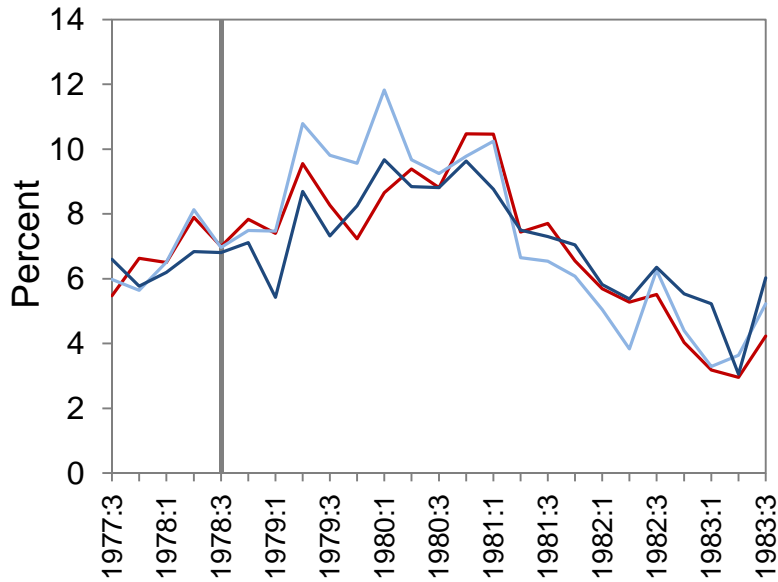


— Core PCE Price Index
 — PCE Price Index
 — GDP Price Index

Inflation Following Low Commitment Shocks (cont.)

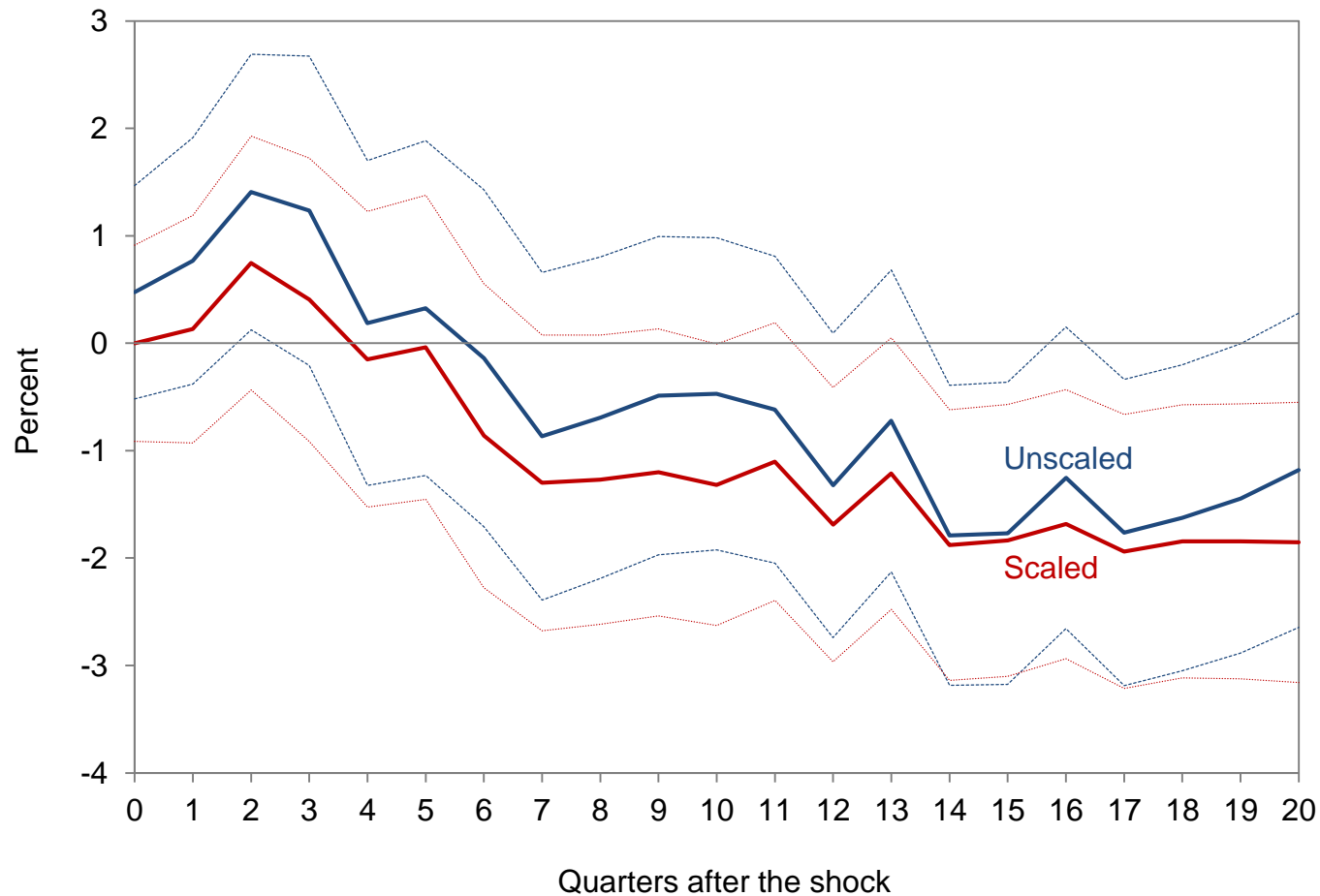
(Quarterly Changes at an Annual Rate)

1978Q3



— Core PCE Price Index — PCE Price Index — GDP Price Index

Response of Inflation to an Attempted Disinflation Using Dummy Scaled by Commitment



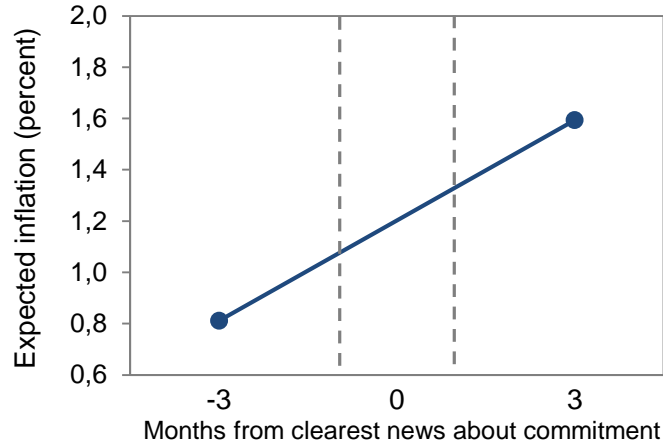
IV. TRANSMISSION OF COMMITMENT THROUGH EXPECTED INFLATION

Approach

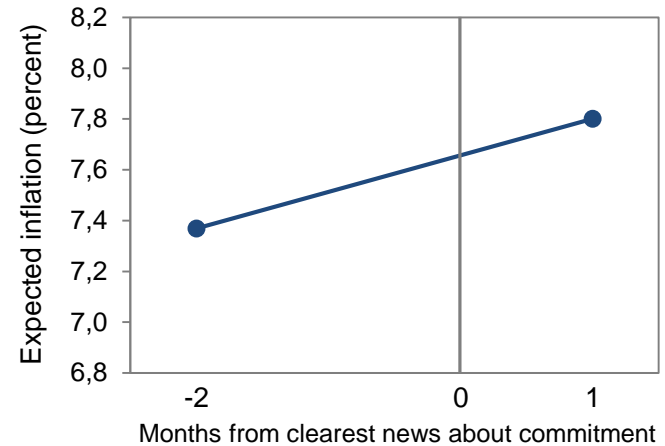
- Use newspaper reports to identify the timing of disinflationary policy and the level of commitment perceived by the public.
- Use data on forecaster inflation expectations (Livingston Survey and Survey of Professional Forecasters).
- Compare expected inflation before and after the news about commitment.

Inflation Forecasts around Times of Reports of High Commitment to Disinflation

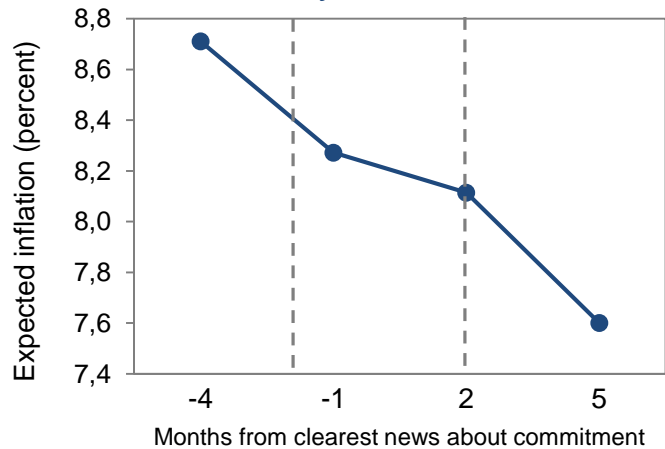
September 1958



October 1979



May 1981



V. TRANSMISSION OF COMMITMENT THROUGH POLICY ACTIONS

Taking the Narrative Analysis of Disinflation Attempts a Step Further

- When did policymakers stop actively pursuing disinflationary policies in each episode?
- Had they achieved their inflation goal when they stopped?
- If not, why did they stop prematurely?

The Ends of Disinflationary Episodes

Shock date	Commitment to disinflation	Effective end date	Duration	Achieved inflation goal?
October 1947	Medium (mixed)	March 1949	17 mos.	Yes
August 1955	Medium	April 1956	8 mos.	No
September 1958	High	March 1960	18 mos.	Yes
December 1968	Low to medium	January 1970	13 mos.	No
April 1974	Low to medium	October 1974	6 mos.	No
August 1978	Low	March 1979	7 mos.	No
October 1979	Medium to high	May 1980	7 mos.	No
May 1981	High	July 1982	14 mos.	Largely
December 1988	Medium	July 1989	7 mos.	Largely

Summary of Findings

- Variation in monetary policymakers' commitment to disinflation has been a critical source of the variation in the success of disinflationary attempts in the U.S.
- Mechanism appears to be through the strength and persistence of the Federal Reserve's disinflationary policy, and not the impact on expected inflation.

VI. EXTENDING THE ANALYSIS TO OTHER COUNTRIES

Narrative Research on Monetary Policy

- **UK:** Batini and Nelson; Nelson; Cloyne and Hürtgen.
- **France:** Monnet
- **Germany:** Tsatsaronis; Clarida and Gertler; Issing; Beyer et al.

Possible Disinflationary Episodes

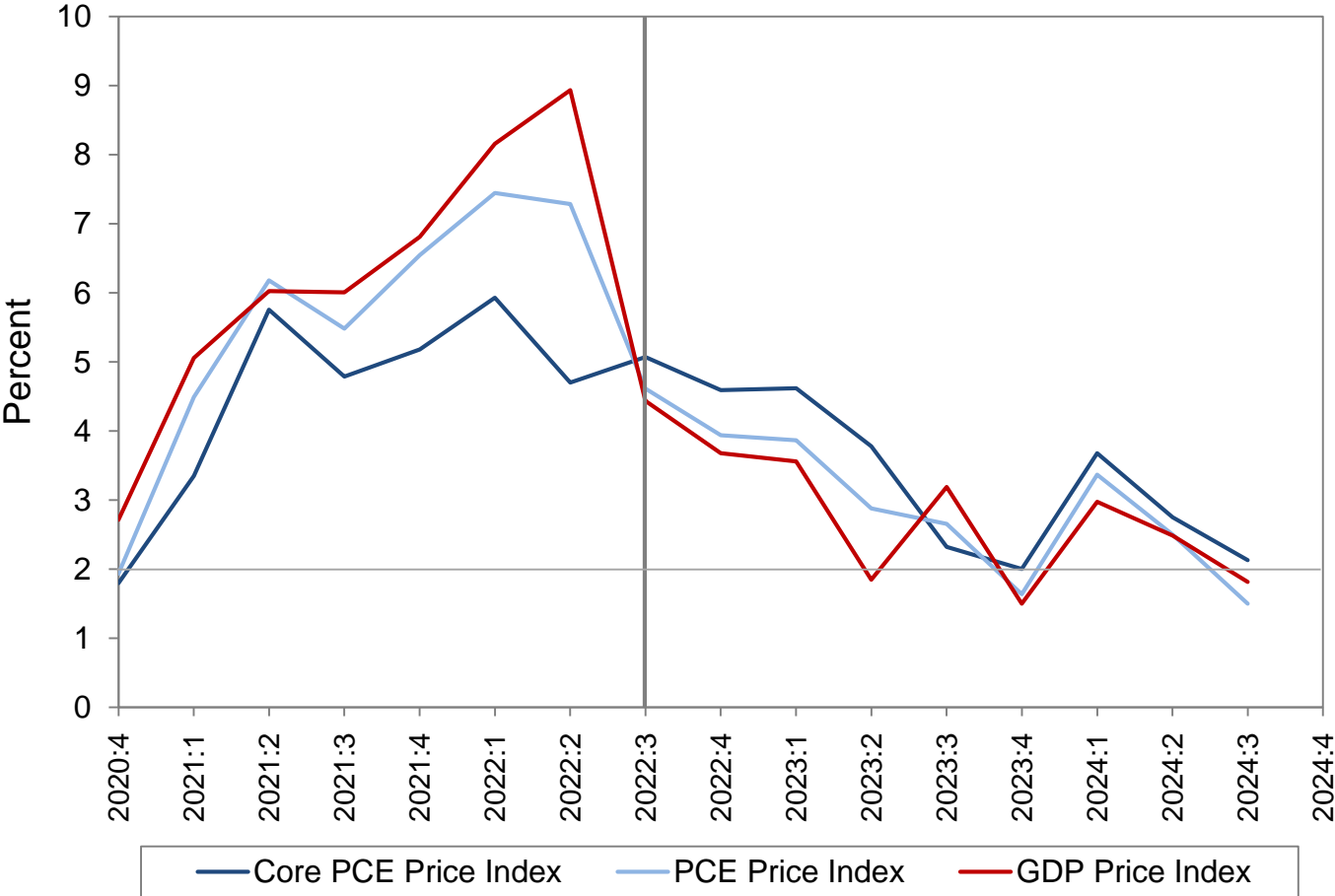
- **UK:** September 1957
May 1979
October 1992
- **France:** September 1948
October 1951
February 1958
February 1963
- **Germany:** May 1973
Fall 1979
August 1991

VII. IMPLICATIONS FOR THE RECENT POLICY

Narrative Evidence on Commitment for July 2022

- “2 percent objective,” “2 percent target,” and “2 percent goal.”
- “We have both the tools we need and the resolve it will take to restore price stability” (Powell Press conference, 7/27/2022, p. 1).
- “While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring **some pain to households and businesses**” (Powell speech, 8/26/2022).
- “likely to involve a **period of below-trend economic growth**” (Powell Press conference, 7/27/2022, p. 4).
- “Powell described the FOMC participants’ projections as involving **“a relatively modest increase in the unemployment rate from a historical perspective”** (Press conference, 9/21/2022, p. 7).

Inflation Following the July 2022 Disinflation Attempt (Quarterly Changes at an Annual Rate)



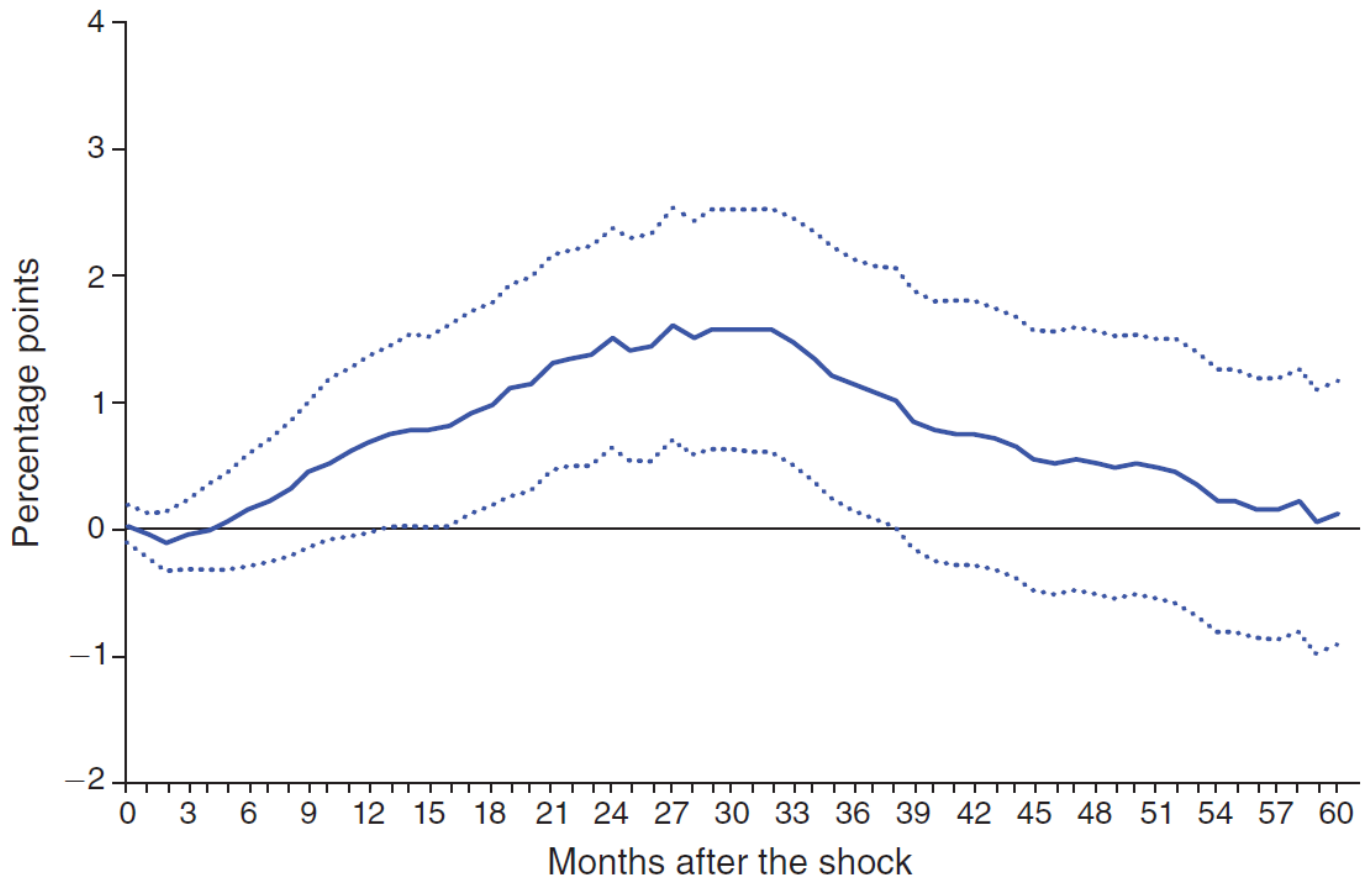
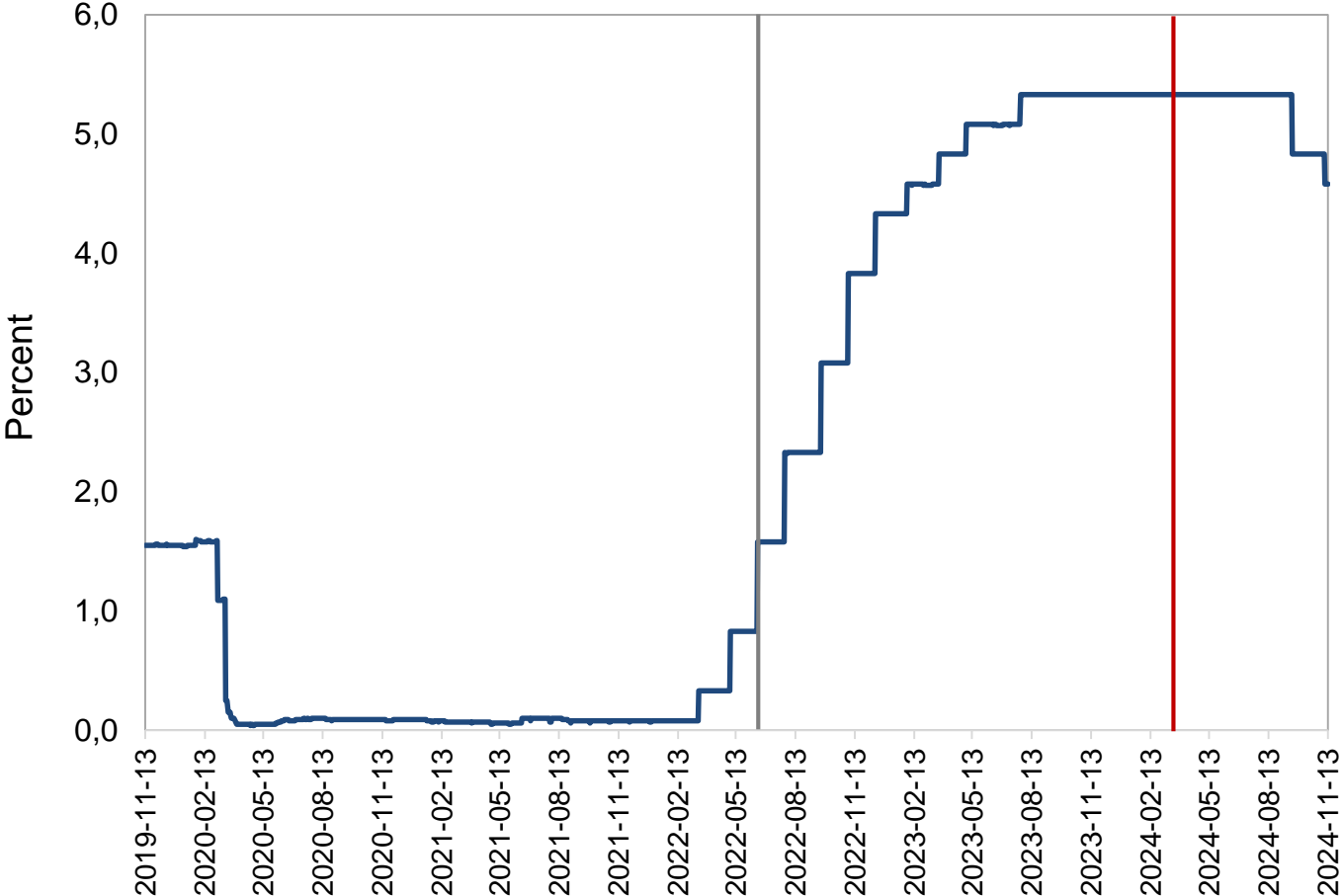


FIGURE 1. RESPONSE OF THE UNEMPLOYMENT RATE TO A MONETARY POLICY SHOCK

From: Romer and Romer, "The Narrative Approach after 35 Years." *American Economic Review*, June 2023.

Federal Funds Rate, 2019–2024



Inflation Following the July 2022 Disinflation Attempt (Quarterly Changes at an Annual Rate)

