Need for an Anchor?

In the 1960/70s:

“Volcker believed that money needed an anchor, some price that was a fixed point, and that an exchange rate tied to gold served that purpose…He was convinced that fixed currencies imparted a necessary discipline on national policy makers, who otherwise would too easily resort to lax fiscal and monetary policies that would lead to inflation.”

Garten (2021), Three Days at Camp David, pg 84

In the 2000:

“Global factors play a significant and increasingly important role in the dynamics of CPI inflation and the cyclical component of inflation.”

Key Question

In the post-Bretton Woods era, have countries found a new “anchor” for achieving price stability in the face of large global shocks?

➢ Compare AEs with “flexible” vs “rigid” ERs
   1. Inflation rate
   2. Inflation sensitivity to common global factor
   3. Inflation sensitivity to specific global shocks
**CPI Inflation: By ER Regime**

**Rigid:** conventional peg, currency board, or no separate legal tender

**Flexible:** independent float, free float, or managed float with no pre-determined path

**Sources:** Based on inflation data from IMF, WEO (10/22) and exchange rate regimes from IMF, AREAR (2022).
Notes: First principal component of annual CPI inflation for a sample of 33 advanced economies. Principal component based on rolling 4-year averages. Underlying data on inflation data from IMF, WEO (10/22) and on exchange rate regimes from IMF, AREAR (2022). See previous slide for exchange rate definitions.
Panel Regression Results: Quarterly CPI Inflation in AEs

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**Notes:** Green is a positive coefficient and red is negative. Darker cells indicate more significance, with ***, **, and * significant at the 1%, 5% and 10% level, respectively. Estimates based on framework developed in Forbes, Gagnon and Collins (2022) for a non-linear Philips curve with global factors. Slack>0 is a dummy if slack is positive and inflation <3%, i.e., the nonlinear “low inflation bend” model. Slack is a principal component of a range of indicators. Inflation data is quarterly, seasonally adjusted and annualized from 1996-2017. See paper for definitions and details.
Summary & Implications

➢ Have pegs been needed to anchor prices (in AEs)?
  ▪ Inflation: no
  ▪ Inflation sensitivity to common global factor: no
  ▪ Inflation sensitivity to specific global shocks: no

➢ Implications
  ▪ Loss of “Golden Anchor” from Bretton Woods has not undermined price stability in AEs (despite the globalization of CPI inflation)
  ▪ Replaced by the “stone columns” of independent, inflation-targeting central banks?
Caveat: Weaker Anchor in EMs