Discussion of: Nonlinear Pass-Through of Exchange Rate Shocks on Inflation
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Estimating pass-through is challenging

Endogeneity - can take many forms, e.g.,

• Domestic interest rates may rise due to a monetary policy response to inflationary pressure, leading to an appreciation of the exchange rate
  - i.e., appreciation may be linked to rising, rather than falling prices

• Among other things, exchange rates influence, and are influenced by domestic/foreign: inflation, future monetary and fiscal policies, productivities, nominal rigidities, economic integration, ...
Estimating pass-through is challenging

- Engel has argued questions about PT should be addressed in the context of the sources of exchange rate changes, e.g.,
  
  in LR: $\uparrow M \Rightarrow d.c. \text{ depr (and) } \uparrow P$, then $PT = 1$, but a similar
  $\downarrow M^* \Rightarrow d.c. \text{ depr (and) } \Delta P=0$, then $PT = 0$

  i.e., the source matters

- But surely this is too restrictive for SR analysis
  - It is a long run proposition
  - Barriers (e.g., pricing power) are absent and free trade is assumed
  - In the SR, a d.c. depr, regardless of the source, may lead to $\uparrow P$

- Nonetheless, the monetary authority still cares about the source
This paper

- Argues its focus is on the inflationary consequences of an exchange rate change: no need to consider the source
  - Not really defensible
  - Despite making a good point that one (favored) alternative approach, i.e., a DSGE model, would embed a PPP assumption, which seems to be rejected by the data

- However, the paper partly addresses this identification problem via its focus on shocks to exchange rates after controlling for many of these exchange rate influences (VAR)
  - And, the 'Historical Decomposition' isolates (historical) sources
  - Pass-through of an 'orthogonal' exchange rate change - in the context of various states of the economy?
  - I think it would be more convincing to bring in additional foreign variables in the VAR (currently only mc*)
This paper

• Focuses on several (too many?) things:
  - The dependence of pt on the state of the economy, the size of the exchange rate shock
  - At various ‘stages’ along the distribution chain
  - Historical Decomposition
  - Asymmetry (+/-)
  - The ‘completeness’ of pass-through
    • In SR and LR
  - Policy implications
Orentiation

• My view: focus on pt at various horizons is distracting
  - Leads to no new conclusions
    • e.g., pt is incomplete
    • e.g., pt increases over time
    • e.g., estimates are less precise as time increases
  - Pushes the identification assumption too hard
  - Competes with other points authors make
    • e.g., pt to different stages

• My view: Asymmetry is over-emphasized
  - pt is roughly the same for +/- shocks
  - Similarly for acceleration/deceleration of exchange rate change (pt is roughly the same)
Puzzles

- Q: Lack of ‘foreign’ variables in VAR
  - Could solve puzzles, e.g., pt is negatively related to openness

- Q: Is the focus on dichotomization forced: (Large/Small), (Positive/Negative); have there been truly ‘big’ differences in e.g., inflation, exchange rate shocks, … over the sample?
  - Are we talking about many more, much larger $<0$, than $>0$?
  - Were there significant reductions in trade barriers or other state variables?
  - Summary statistics would answer these questions
Orientation

• A negative conclusion: “….there should not exist a specific rule on pass-through on inflation for policy making…”

However,

- Your conclusions emphasize many influences, esp., state of the economy, and size of shocks

- And you note that ‘...decisions cannot wait up to the time when experts identify shock…”

- What to do?

• Table 8 (important) needs better motivation

  - This table, and the Historical Decomposition should form the key take-a-ways. This should let you frame the discussion in terms of sources explicitly
A comparison to Frankel-Parsley-Wei

(1) Exchange Rate Passthrough to Domestic Prices

(2) Passthrough and Inflation
(Above and below median inflation country groups)

(1) Similar to Rincon and Rodriguez’s Historical Decomposition results
(2) The monetary climate seems important: pt is significantly higher in an environment of high inflation
Conclusion

• Interesting paper on an important subject
• Nice methodology
• I learned a lot

• Thank you!