

# Does the transmission of monetary policy shocks change when inflation is high?

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discussed by Michael Weber  
Purdue University, ESMT, CEPR, NBER

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# Big Picture

- Optimal monetary policy response depends on nature of shock
- Conventional prescription:
  - Respond more than one for one to demand-driven inflation
  - “Look through” (transitory) supply shocks
- Focus on core rather than headline inflation
  - Theoretical underpinning Aoki (2001): stabilize “sticky-price” index

# This Paper

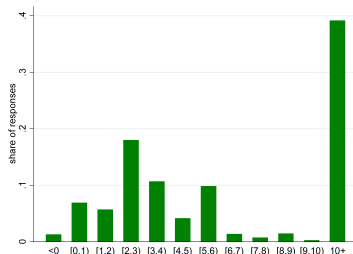
- State dependence in transmission of monetary shocks
- Use of Bayesian threshold VAR
- High inflation:
  - More persistent response of output and inflation to conventional shocks
  - But smaller peak response in output and inflation
  - Liquidity shocks more expansionary
- Financial market response key mediator
- **Bottom line:** great paper everyone should read!!

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - Textbook prescription assumes anchored inflation expectations

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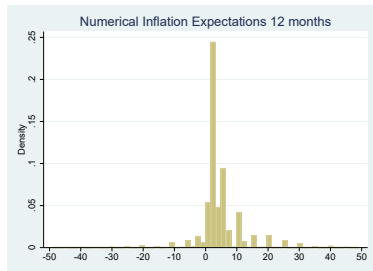


Source: Coibion, Gorodnichenko, Weber, JPE (2022):  
*"Monetary Policy Communication and Households' Inflation Expectations"*

- Large dispersion in perceived Fed inflation target
- Expectations do react to info and determine actual consumption in scanner data

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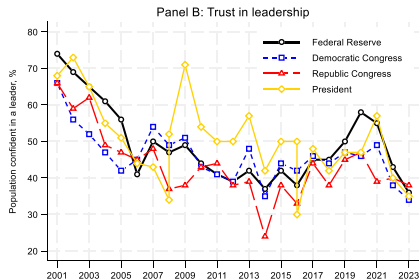


Source: D'Acunto & Weber, Annual Review of Economics (2024):  
*"Why Survey-Based Subjective Expectations Are Meaningful and Important"*

- Large cross-sectional dispersion at each point in time

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - Level of inflation might undermine credibility



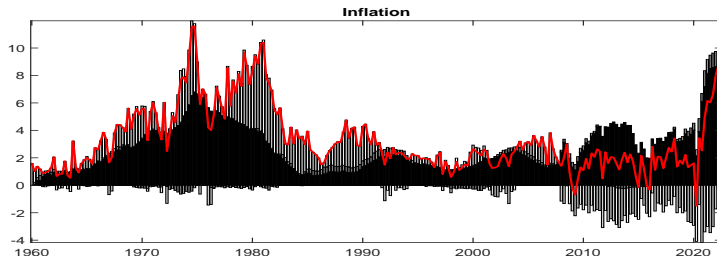
Source: Weber et al, Econometrica (2025):

*"Tell me Something I don't Already Know: Learning in Low- and High-Inflation Settings"*

- Distrust in any institution declining but similar in 2023 as in 2014 for Fed

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - High debt level might signal fiscally-led regime

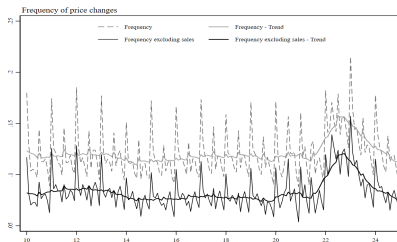


Source: Bianchi, Faccini & Melosi, QJE (2023):  
*"A Fiscal Theory of Persistent Inflation"*

- Unfunded fiscal transfers and inflation strongly positively correlated

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - Menu cost models suggest higher FPA to larger shocks



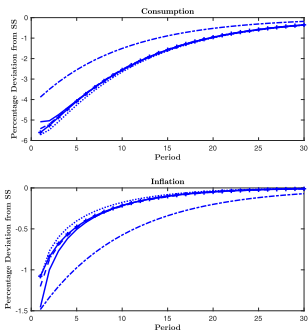
Source: Gautier et al, ECB WP (2025):

*“Consumer price stickiness in the euro area during an inflation surge”*

- FPA increases during inflation surges

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - Interlinkages via production networks



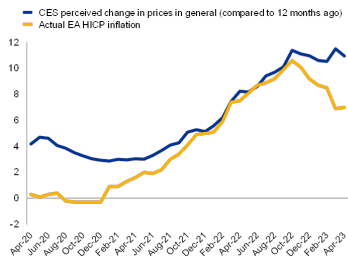
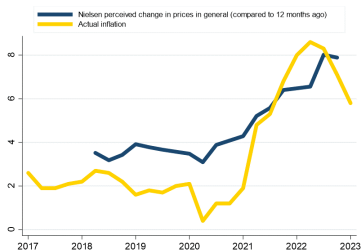
Source: Pasten, Schoenle & Weber, JME (2020):

*"The propagation of monetary policy shocks in a heterogeneous production economy"*

- Energy input into many sectors
- Larger real effects in heterogeneous economy compared to "sticky" homogeneous economy

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - Household and firm attention state dependent



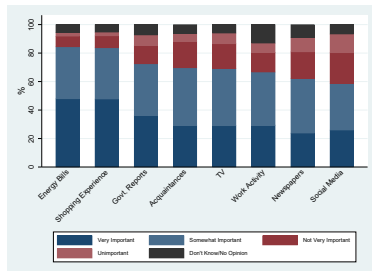
Source: Weber et al, Econometrica (2025):

*"Tell me Something I don't Already Know: Learning in Low- and High-Inflation Settings"*

- Higher attention during inflation surges

# Why Should Level of Inflation Matter?

- Possible reasons to deviate from textbook:
  - Household pay special attention to food and energy prices



Source: D'Acunto & Weber, WP (2025):  
*"Information and Macroeconomic Expectations: Global Evidence"*

- Higher attention to salient price changes

# Conventional MP Shock during High and Low Inflation

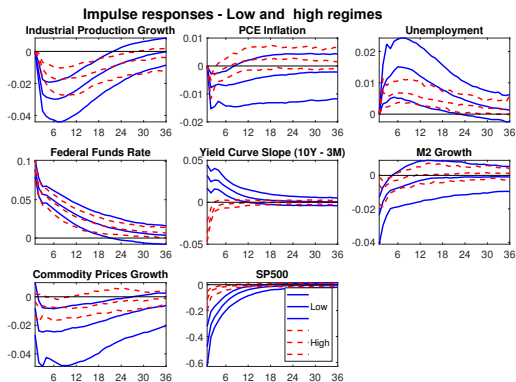


Figure 7: Contractionary conventional monetary policy shocks, different regimes.

- Larger impact response but less persistent for low inflation regime
- Slope of term structure key differentiator

# Role of Inflation Expectations

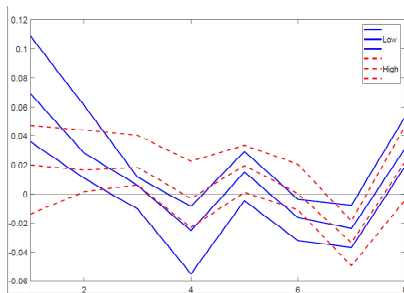


Figure 11: Responses of CPI inflation expectations, conventional policy shocks

- Inflation expectations key

**Suggestion:** directly add inflation expectations to VAR

## Sample Period: 1960 – 2023

- Financial markets response key mediator for results
- But financial markets have changed tremendously since then
- Conduct of monetary policy has changed tremendously

**Suggestion:** look at subsamples

Sample Period: 1984 – 2019

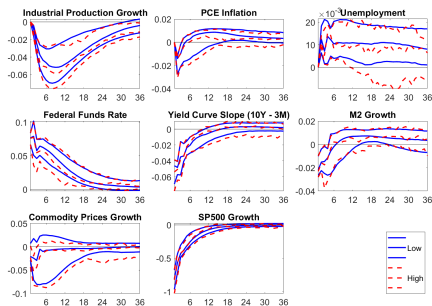


Figure F-3: Contractionary conventional monetary policy shocks, 1984-2019.

- Identical response in high and low inflation regime
- But limited variation in inflation

**Suggestion:** look at subsample until 2023

# Empirical Model

- Single threshold
- Affects all variables
- NB: scalar volatility parameter affects level of endogenous variables (GARCH-M models)

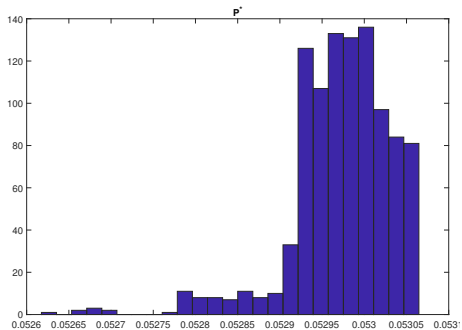
**Suggestion:** motivate assumptions more

# What is a Liquidity Shock?

- “Increase in amount of money in circulation”
- Engineered through a decrease in the long-term interest rate
- Assumed to have no effect on growth rate of real activity, UR, inflation within month
- Short rate remains unchanged to ensure no sterilization
- Primitive shocks
  - Delphic Forward guidance shock
  - Large scale asset purchase (asset swaps)
  - Open market operation shocks conducted in the 1980s and 1990s

**Suggestion:** during subsamples maybe easier to interpret or drop entirely?

## Regime Threshold I

(a)  $P^*$

# Regime Threshold II

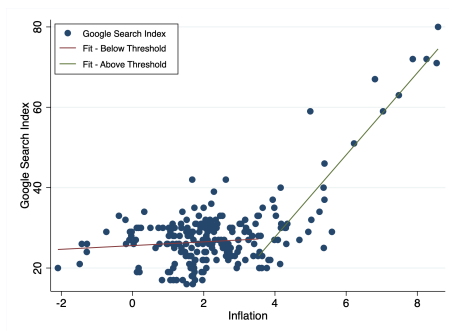


Figure 1: Threshold model fit for the U.S. ( $\hat{\gamma} = 3.55$ )

Source: Korenok, Munro, and Chen Restat (2026):  
*"Inflation and attention thresholds"*

- Lines up with U.S. evidence on google searches: stress more

# Conclusion

- Novel insights into state-dependence of monetary policy
- Narrative of timely & robust empirical results needs more discussion
- Great paper everyone should read