Research Working Papers

Shocks, Frictions, and Policy Regimes: Understanding Inflation after the COVID-19 Pandemic

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Fiscal and monetary policies likely contributed to the persistent rise in inflation during the post-pandemic period.

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We set-up a two-sector New Keynesian model with input-output linkages and monetary fiscal policy interactions to study the post-COVID-19 inflation. We test alternative calibrations of the model based on the fit of aggregate inflation, using shock estimates obtained by fitting goods inflation. Our preferred model suggests that fiscal shocks not offset by monetary policy account for the initial inflation surge in the first half of 2021 while supply-side shocks have emerged as main drivers of inflation since then. Multiple factors ("supply-side disruption", "expansionary policy", and "sectoral reallocation shock") played an important role at different phases of the recent inflationary episode.

JEL Classifications: E53; E62; E63

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