"Do Geopolitical Risks Raise or Lower Inflation?"

by Dario Caldara, Sarah Conlisk, Matteo Iacoviello, and Maddie Penn

Riccardo Sabbatucci

Stockholm School of Economics/SHoF

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What Is This Paper About?

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- **Contributions:**
  1. Exploring the relationship between geopolitical events and inflation for a large set of countries (existing studies focus on other outcome variables)
  2. Highlight transmission channels of geopolitical tensions leading to inflation (e.g., higher military spending, public debt, currency depreciation)

Findings

Using panel (S)VARs the paper finds that geopolitical (GPR) risks:

- Comove positively with inflation (Caldara and Iacoviello, AER 2022)
- Lead to lower (higher) economic activity outside (in) the US
- Results in an increase of public debt and money growth, and less trade with RoW
- Net effect on inflation is positive: mainly due to higher commodity prices and dollar appreciation (e.g., countries ex-US experience a currency depreciation)

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  - **Household characteristics**: e.g., education level, services vs. manufacturing activity ratio, wealth heterogeneity, real wages, inflation expectations, unemployment rates, risk aversion
  - **Firm characteristics**: e.g., size, price setting stickiness, industry composition, global suppliers/customer network structure

Comment I: Household/Firm Characteristics

- These are time-varying, structural characteristics of countries, often not determined by short-term fiscal policies such as military expenditures
- In other words: characteristics of households and firms might matter in the transmission of a GPR shock by affecting both demand and supply forces
  - Example: Italians are more risk averse than Scandinavians, and hence perhaps cut their consumption more following a GPR shock (deflationary), but manufacturing in Italy is more relevant than in Sweden, hence the price of final goods produced increases more (inflationary)
- **Suggestion:** Could you control for some of these variables and see how the VAR estimation/IRFs are affected?

Comment II: Relationship With Other Measures

- How do other real-time, "high-frequency" measures of economic and financial conditions (e.g., EPU/VIX/Macro Uncertainty) relate to GPR, and to what extent they "co-lead" future inflation?
- Cannot add them into a regression specification together with fixed effects. However, one econometric option is to obtain the GPR components orthogonal to these variables, and use these "cleaned" GPR shocks in the VAR. This would give a cleaner lead-lag relationship generated from a "pure" GPR shock
- How about the high-frequency (monthly), contemporaneous effect of GPR shock on domestic deposit rates, capital flows (if available at high frequency), exchange rates dynamics?

Minor Comments

- Bivariate/panel VAR econometrics specifications described in the paper?
- Not completely sure about the methodology used in Section 5.1 (Russia invasion) – clarify a bit?
- Specification in Section 4 (Table 2) seems to have *changes* in inflation as outcome variable. Is there a reason to change the LHS wrt to the other Panel VAR spec?
- Other outcome variables? E.g., short-term dynamics vs long-term impulse-responses
- Forecasting geopolitical risk – applications? Suppose we believe that China is going to attack Taiwan by the end of 2024 and hence expected GPR will increase. Can I use this information to improve my forecasting models?

Conclusion

- I like the idea of the paper. It uses the brilliant GPR index previously developed by the authors to forecast inflation
- Potentially very useful to complement standard inflation forecasting models at medium horizons. Horse-race with standard inflation forecasting models?
- Looking forward to the next version. Good luck with the paper!