Are Phillips curves in CESEE still alive and well behaved?

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Based on original research by Florian Huber and Josef Schreiner

Vienna, November 16, 2023

Central, Eastern and Southeastern European Section
www.oenb.at
Motivation
Visible disconnect between labor market and price developments in CESEE for at least the past decade…

…but the Phillips curve has also received a lot of attention in the economic literature in recent years (see e.g. Stock and Watson, 2019, and Del Negro, et al., 2020)

⇒ Is the Phillips curve in CESEE still alive and well behaved?

Contributions to the literature:

- Analysis of PC in the CESEE region
- Flexible modelling / nonlinearities

In search for the Phillips curve in CESEE over the past two decades

Development of HICP inflation and unemployment rates

**Czechia**

**Year-on-year change in %**

**Hungary**

**Year-on-year change in %**

**Poland**

**Year-on-year change in %**

**Romania**

**Year-on-year change in %**

Source: Eurostat.
At times, co-movements were even in stark contrast to the theory

Correlation between HICP inflation and unemployment rates

Correlation over the whole period

Czechia

Coefficient of correlation

Hungary

Coefficient of correlation

Poland

Coefficient of correlation

Romania

Coefficient of correlation

Source: Authors’ calculations.
Cyclical effects dominate over structural dis-inflation trend

Development of core inflation and its cyclical and noncyclical components

Source: Eurostat, authors' calculations.
Empirical results
Simulating shocks to the unemployment rate

Impulse response functions of the unemployment rate to different positive shocks

Czechia
Percentage points

Hungary
Percentage points

Poland
Percentage points

Romania
Percentage points

Source: Author's calculations
Note: Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong (solid line), medium (dashed line) and weak (dotted line) unemployment shock.
Asymmetric shocks in Czechia and Poland

Impulse response functions of the unemployment rate to a strong positive and strong negative shock

**Czechia**
Percentage points

**Hungary**
Percentage points

**Poland**
Percentage points

**Romania**
Percentage points

Source: Author's calculations

Note: Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong positive (blue line) and strong negative (purple line) unemployment shock.
How do unemployment shocks of different sizes affect HICP-inflation?

Impulse response functions of the HICP to different positive shocks

Czechia
Percentage points

Hungary
Percentage points

Poland
Percentage points

Romania
Percentage points

Source: Authors’ calculations
Note: Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong (solid line), medium (dashed line) and weak (dotted line) unemployment shock.
How do unemployment shocks of different signs affect HICP-inflation?

Impulse response functions of the HICP to a strong positive and a strong negative shock

Czechia

Percentage points

Hungary

Percentage points

Poland

Percentage points

Romania

Percentage points

Source: Author’s calculations

Note: Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong positive (blue line) and strong negative (purple line) unemployment shock.
Summary of all results

Impact of a large unemployment shock on...

<table>
<thead>
<tr>
<th></th>
<th>in percentage points</th>
</tr>
</thead>
<tbody>
<tr>
<td>...HICP inflation</td>
<td>1.1 - 1.6</td>
</tr>
<tr>
<td>...core inflation</td>
<td>0.8 - 1.3</td>
</tr>
<tr>
<td>...cyclical core inflation</td>
<td>0.9 - 1.4</td>
</tr>
<tr>
<td>...noncyclical core inflation</td>
<td>0.5 - 1.2</td>
</tr>
</tbody>
</table>

Difference in the impact of a large negative and positive shock on...

<table>
<thead>
<tr>
<th></th>
<th>in percentage points</th>
<th>Poland</th>
<th>Czechia</th>
</tr>
</thead>
<tbody>
<tr>
<td>...HICP inflation</td>
<td>0.4</td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>...core inflation</td>
<td>0.2</td>
<td>0.8</td>
<td></td>
</tr>
<tr>
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<td>0.3</td>
<td>0.8</td>
<td></td>
</tr>
<tr>
<td>...noncyclical core inflation</td>
<td>0.3</td>
<td>0.7</td>
<td></td>
</tr>
</tbody>
</table>
Phillips curve exhibits substantial nonlinearities

• Only strong unemployment shocks induce a significant, broad and lasting effect on inflation
• Inflation often reacts more strongly to negative than to positive unemployment shocks

Inertia in the Phillips curve relationship

• It takes around two and a half years until a shock reaches its full impact

Policy implications

➢ Under current macroeconomic circumstances both of the above call for a strong and decisive macroeconomic demand management to keep inflation in check.
➢ The functioning of the Phillips curve might also be impaired by the CESEE region’s chronically tight labor markets.
Danke für Ihre Aufmerksamkeit

Thank you for your attention

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How do unemployment shocks of different sizes affect core inflation?

Impulse response functions of core inflation to different positive shocks

Czechia
Percentage points

Hungary
Percentage points

Poland
Percentage points

Romania
Percentage points

Source: Authors' calculations
How do unemployment shocks of different signs affect core inflation?

Impulse response functions of core inflation to a strong positive and a strong negative shock

Czechia
Percentage points

Hungary
Percentage points

Poland
Percentage points

Romania
Percentage points

Source: Authors’ calculations
Note: Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong positive (blue line) and strong negative (purple line) unemployment.
How do unemployment shocks of different sizes affect cyclical core inflation?

Impulse response functions of cyclical core inflation to different positive shocks

**Source:** Authors' calculations

**Note:** Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong (solid line), medium (dashed line) and weak (dotted line) unemployment shock.
How do unemployment shocks of different signs affect cyclical core inflation?

Impulse response functions of cyclical core inflation to a strong positive and a strong negative shock

Source: Authors’ calculations

Note: Median and 16th and 84th credible intervals of the posterior distribution of the dynamic responses to a strong positive (blue line) and strong negative (purple line) unemployment shock.
How do unemployment shocks of different sizes affect noncyclical core inflation?

Impulse response functions of noncyclical core inflation to different positive shocks

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Percentage points

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