

Discussion of:
“Oil Prices, Gasoline Prices, and Inflation Expectations”
by Lutz Kilian and Xiaoqing Zhou

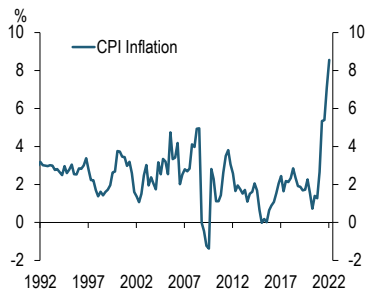
A. Lee Smith
FRB Kansas City

J.P. Morgan Center for Commodities
New Directions in Commodities Research Symposium
August 2022

The opinions expressed herein are those of the authors and do not reflect the views of the Federal Reserve Bank of Kansas City or Federal Reserve System.

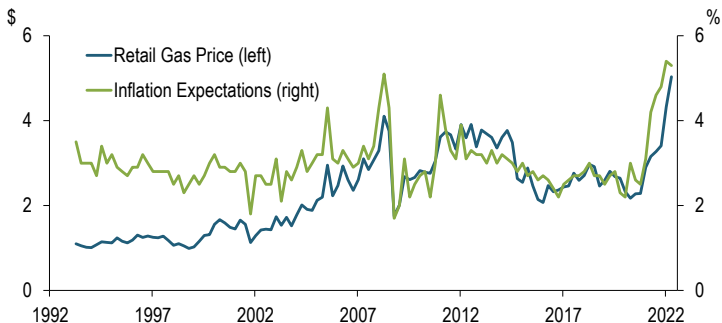
A confluence of factors has lifted inflation to 40-year highs

- ▶ Fiscal/Monetary stimulus
- ▶ Pent-up pandemic demand
- ▶ Supply disruptions
- ▶ Russian-Ukraine war



Source: BLS, Haver Analytics

Growing concern that record high gas prices will lead to a persistent increase in inflation expectations.



Source: Department of Energy, University of Michigan, Haver Analytics

[Inflation] expectations are very much at risk due to high headline inflation

- Federal Reserve Chair Jerome Powell, June 15, 2022

Recent line of research by Kilian and Zhou

Rigorous time-series analysis of linkages between gas prices and inflation expectations

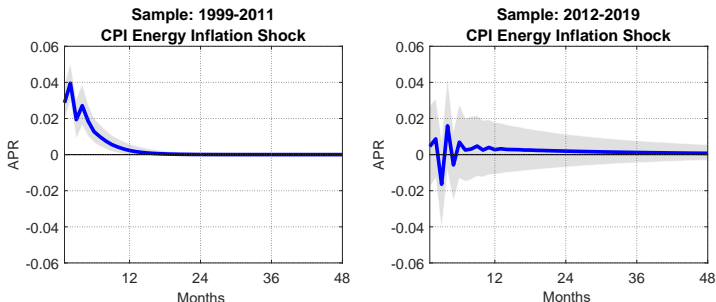
Key Results:

1. Consumer inflation expectations are primarily driven by factors other than gasoline prices.
2. Consumer inflation expectations show only a modest, temporary increase in response to higher gasoline prices.
3. Long-run expectations show an even smaller response to changes in gasoline prices than do short-run expectations.

Policy Takeaway: Fears that rising gas prices could set off a spiraling of inflation and inflation expectations are overstated.

The good: Evidence of improved anchoring pre-COVID

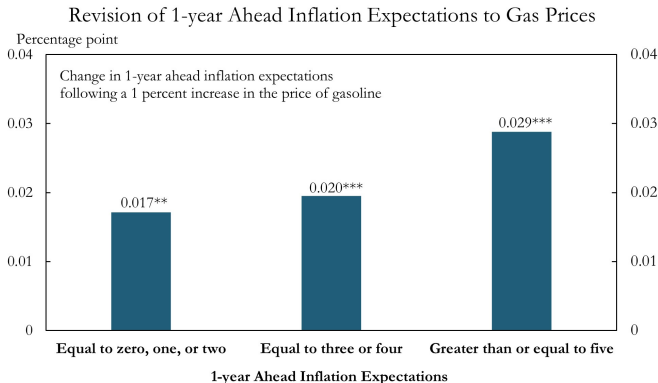
University of Michigan Expected Inflation 5-10 Years Ahead



Source: Bundick and Smith (2021) *Did the Federal Reserve Break the Phillips Curve? Theory and Evidence of Anchoring Inflation Expectations*

This compliments the findings to Kilian and Zhou and shows that their results are robust.

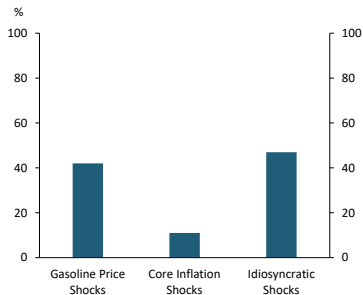
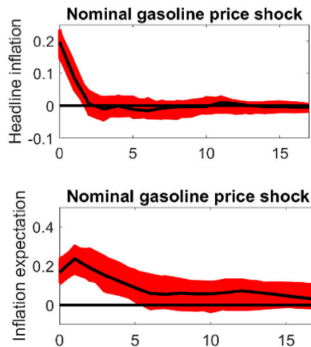
The bad: Caution extrapolating results to current episode



Source: Cakir-Melek, Dillon, and Smith (2022) *Will rising gasoline prices set off an inflationary spiral?*, Forthcoming, Federal Reserve Bank of Kansas City Economic Review

The unprecedented sequence of inflationary shocks could elicit different effects than the historical “average” gas price shock.

The ugly: Consumer inflation expectations still a mystery



Source: Kilian and Zhou (2022) *Oil Prices, Gasoline Prices, and Inflation Expectations*

If not gas prices, then what is the primary driver of consumer inflation expectations?

Conclusion

Kilian and Zhou have done fantastic work on a timely and policy relevant topic!

This research opens the door for further analysis to understand what drives consumer inflation expectations, if not gas prices.

Much more work is needed in this area as policymakers continue to grapple with the mystery of what shapes consumer inflation expectations.