Testing the Invariance of Expectations Models of Inflation

Abstract:

The new-Keynesian Phillips curve (NKPC) includes expected future inflation as a major feed-forward variable to explain current inflation. Models of this type are regularly estimated by replacing the expected value by the actual future outcome, then using Instrumental Variables (IV) or Generalized Method of Moments (GMM) methods to estimate the parameters. However, the underlying theory does not allow for various forms of non-stationarity in the data--despite the fact that crises, breaks and regimes shifts are relatively common. We investigate the consequences for NKPC estimation of breaks in data processes using the new technique of impulse saturation, and apply the resulting methods to salient published studies to check their viability.