

**Report on manuscript No. 92-1 "Endogenous Indexing and Monetary Policy Models" by Richard Mash**

## **1 Summary**

Mash(2007) begins by noting that the hybrid Phillips curve models(e.g. Gali and Gertler (1999), Christiano, Eichenbaum and Evans (2005)), which arise through indexation or through rule of thumb price-setters, assume that the indexing parameter is exogenous. The success of the hybrid models in matching some key facts that describe inflation dynamics depends on the assumption that the degree of indexation is high.

This paper attempts to endogenize this parameter in these models by linking the indexing parameter to the degree of inflation persistence in the economy. The paper presents two models. One model corresponds to the scope of the Gali and Gertler model. The other one corresponds to the scope of Christiano et al. (2005) model. The second model is referred to as a"LAPI" model. In these models the indexing parameter gets a high value only if inflation is persistent. The paper claims that once the indexing parameter is endogenized, the indexing parameter is small and therefore the hybrid models would not be able to generate the inflation dynamics that we observe in the data.

## **2 Comments**

I find this paper an interesting one but the new models presented in this paper are not better than the hybrid models. The Gali-Gertler model lacks microfoundation. Endogenizing the indexing parameter in the way proposed by the author does not make the model microfounded. Christiano et al. (2005) resolve this problem by appealing to dynamic indexation. However, many authors are skeptical about indexation on the grounds that there is no microevidence for this sort of indexation required occurring. To be precise, the Calvo model with indexation implies that every firm adjust its price every period, which is inconsistent with the evidence provided by the Inflation Persistence Network(e.g. Dhyne et al.) and Bils and Klenow (2004). These studies show that prices do not change continuously. This insight also goes against the LAPI model.

The important question is that is there any evidence that price setting behaviour of firms depends on the degree of persistence in inflation? if there is indeed evidence that supports the author's claim, I am left wondering why it is not reported. If there is no evidence, then why we should care about the LAPI model presented in this paper. If the main goal of the paper is to illustrate the shortcomings of the existing hybrid models, the shortcomings of these models are already well known (e.g. Woodford (2007)). So, I am left where I started.

## References

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