Forcing A Synthesis: Technology, Effective Hours, and Inflation

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Abstract

We review the fundamental dynamics of US inflation through the lens of the New Keynesian Phillips Curve (NKPC). Typical issues encountered in this literature include: resolving the tension between low fixed-price durations from survey information and from econometric studies; the role of forward versus backward looking determinants; and the correct measure of real marginal cost. On the latter, researchers typically use labor share or time-series measures of the output gap. We argue these have dubious properties and inappropriate cyclical features. We estimate a CES production supply side to determine secular real marginal costs and supplement that with a wage overtime premia. Taken together, these have the correct cyclical properties expected of real marginal costs and when inserted into NKPCs provide plausible duration estimates and also suggest a strong inertial role for inflation dynamics.