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# International Evidence on the Efficacy of new-Keynesian Models of Inflation Persistence\*

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## SUMMARY

We take an agnostic view of the Phillips curve debate, and carry out an empirical investigation of the relative and absolute efficacy of Calvo sticky price (SP), sticky information (SI), and sticky price with indexation models (SPI), with emphasis on their ability to mimic inflationary dynamics. We look at evidence for a group of 13 OECD countries, and consider three alternative measures of inflationary pressure, including the output gap, labor share, and unemployment. We find that the SPI model is preferable to the Calvo SP and the SI models because it captures the type of strong inflationary persistence that has in the past characterized the economies in our sample. However, two caveats to this conclusion are that improvement in performance is driven mostly by lagged inflation and that the SPI model overemphasizes inflationary persistence. There appears to be room for improvement in all models in order to induce them to better “track” inflation persistence.

*JEL classification:* E12, E3, C32

*Keywords:* sticky price, sticky information, empirical distribution, model selection.

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# 1 Introduction

In this paper we take an agnostic view of the new-Keynesian Phillips curve debate, and carry out an empirical investigation of the relative and absolute efficacy of sticky price, sticky information, and sticky price with indexation models, with emphasis on their ability to mimic inflationary dynamics. In particular, we examine data for a group of 13 OECD countries, and we consider three alternative measures of inflationary pressure, including the output gap, labor share, and unemployment. Our findings suggest that two of the three formulations that we consider (i.e. the “non-hybrid” formulations) exhibit little persistence prevalent in inflation, while the other formulation tends to overemphasize inflationary persistence.

Although a variety new-Keynesian Phillips curve formulations are used in the theoretical and empirical macroeconomics literatures,<sup>1</sup> there remains an ongoing debate concerning which model is preferable, particularly with regard to producing realistic inflation dynamics. Amongst the many alternative formulations, the Calvo (1983) random price adjustment characterization (i.e. the sticky price (SP) model) is oft cited as the most widely used.<sup>2</sup> In an important paper, however, Fuhrer and Moore (1995) show that the SP model falls short when used to explain inflation persistence, one of the stylized empirical facts describing US inflation.<sup>3</sup> To improve the sorts of inflation persistence implied by the SP model, two leading contenders incorporate additional frictions into the model. One is the sticky price with dynamic indexation (SPI) model proposed by Gali and Gertler (1999), Christiano *et al.* (2005), Smets and Wouters (2003), and Del Negro and Schorfheide (2005). They add lags of inflation into the Calvo model, resulting in the so-called “hybrid” model; so-named because lags are introduced without theoretical justification. Another is the sticky information (SI) model proposed by Mankiw and Reis (2002). They posit that information about macroeconomic conditions spreads slowly because of information acquisition and/or re-optimization costs. Prices in their setup are always readjusted, but decisions about prices are not always based on the latest available information as is

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<sup>1</sup>See e.g. Goodfriend and King (1997), Rotemberg and Woodford (1997), Clarida *et al.* (1999), Smets and Wouters (2003), Woodford (2003), Christiano *et al.* (2005) and the references cited therein

<sup>2</sup>For example, Rotemberg and Woodford state that: “By far the most popular formulation of the new-Keynesian Phillips curve is based on Gulliermo Calvo’s (1983) model of random price adjustment.”; and Mankiw and Reis (2002) state that: “As the recent survey by Richard Clarida, Jordi Gali, and Mark Gertler (1999) illustrates, this model is widely used in theoretical analysis of monetary policy. Bennett McCallum (1997) has called it ‘the closest thing there is to a standard specification.’ ”

<sup>3</sup>Additionally, Gali and Gertler (1999) find that the output gap is either not statistically significant, or even if it is statistically significant, has the wrong sign. Mankiw and Reis (2002) note that such models have trouble explaining why shocks to monetary policy have delayed and gradual effects on inflation (see also Bernanke and Gertler (1995) and Christiano *et al.* (2000)). Ball (1994) finds that the SP model yields the controversial result that an announced credible disinflation causes booms rather than recessions.

the case in the SP model.<sup>4</sup>

A further impetus for our research derives from a strand of the literature where it is argued on theoretical and empirical grounds that labor share is a more appropriate measure of inflationary pressure than the output gap: it is persistent; current inflation is positively correlated with future labor shares in the model and in the data; estimated models yield correct signs when it is used as a measure of inflationary pressure; and such models yield good in-sample fit (see Gali and Gertler (1999) and Sbordone (2002)). However, Rudd and Whelan (2007), among others, criticize the use of labor share as a poor measure of inflationary pressure. They point out that in a broad class of models, labor share moves procyclically (see e.g. Woodford (2003b)) while observed labor shares have a clear countercyclical pattern. In addition they argue that labor share does not improve in-sample fit of the SP model. Thus, again, there is debate; this time concerning which measure is reasonable. Our approach is to examine the three measures mentioned above: output gap, labor share, and unemployment.

Our objective in this paper is also to be agnostic with respect to the economic structure outside of the inflation model. In particular, the rest of economy is approximated with a vector autoregression (VAR), an approach advocated by Fuhrer and Moore (1995). Following Fuhrer and Moore, we limit the space of parameters over which we maximize the likelihood to those that produce a unique rational expectations solution. Our reduced-form VAR provides a good fit, and also reduces the number of maintained hypotheses concerning the structure of the economy, hence allowing us to focus solely on inflation. In addition to standard measures of model performance, such as a models' ability to match theoretical and historical inflation autocorrelations, and the overall goodness of fit, we compare the "closeness" of simulated and historical joint distribution functions of inflation and lagged inflation, and rank our three models.<sup>5</sup>

In research closely related to ours, Fukac and Pagan (forthcoming) strongly advocate limited information analysis as an important compliment to the use of fully specified structural models. However, our paper is probably closest to those of Fuhrer (2006), Kiley (2007), and Rudd and Whelan (2007), although all three papers consider only U.S. data; the first and the third papers do not examine sticky information formulations; the second paper forms hybrid versions of all of the formulations that it examines; and none of the papers jointly consider all three of the inflationary measures discussed above.

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<sup>4</sup>The model is representative of the wider class of rational inattention models developed by Phelps (1967), Lucas (1973), and more recently by Mankiw and Reis (2002), Sims (2003), and Woodford (2003a).

<sup>5</sup>This is done using the distributional accuracy test of Corradi and Swanson (2005a, 2007a).

The lessons that we learn from our empirical investigation are quite clear-cut. First and foremost, the inflationary dynamics implied by the SP and SI models are very different from those of the SPI model, as might be expected, given that the SPI model is our only hybrid model. In particular, our empirical evidence suggests that the SP and SI models fall short of capturing inflation persistence that has in the past characterized the economies of most of the countries in our sample, as the residuals of the estimated versions of the both models are highly autocorrelated. This feature is not mitigated if either: (i) we use alternative measures of inflationary pressure such as labor share or unemployment, (ii) we use random information instead of price adjustment (i.e. if we use the SI model instead of the SP model), or (iii) we consider an alternative sample period from 1983-2005.

Our findings extend current knowledge in several directions. First, the finding that the SP model performs relatively poorly when labor share is used as a measure of inflationary pressure extends the results of Fuhrer (2006) and Rudd and Whelan (2007) to a multiple country dataset. Indeed, none of our inflationary pressure measures perform particularly well. There are no cases, across the countries investigated, where the sign of the inflationary pressure coefficients in our models are all correct, let alone statistically significant. For US data, our unique rational expectations solution gives an estimated coefficient on the labor share of roughly one tenth the size reported by Gali and Gertler (1999) and Sbordone (2002); no unique solution exists for our system if this parameter is restricted to correspond to the value reported by the above authors. Moreover, we find that the sticky price model with indexation overemphasizes inflationary persistence. Autocorrelations are generally larger than those observed in the historical record; although as shall be discussed below, autocorrelations vary (sometimes greatly) from decade to decade. Finally, we note that the SPI model performs well everywhere except in the region of the joint distribution of current and lagged inflation where both are negative. This region is not populated at all in the historical record, but simulated SPI data sometimes are found here. This problem is clearly related to the excess persistence of the SPI model. The above discussion clearly underscores the “frailty” of all of our models, and suggests that further research is needed not only in order to find “better” models in terms of persistence properties, as discussed in the abstract, but also to find models for which parameterizations are more robust.

Second, in contrast to numerous recent papers concluding that the SI model is comparable to a current “benchmark”, we argue that the close proximity between SP and SI models arises from their failure to capture inflation persistence.<sup>6</sup> This result, again, arises in our particular context, and given

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<sup>6</sup>There is a rich literature comparing SP and SI models (see e.g. Mankiw and Reis (2002), Khan and Zhu (2006), Korenok (2008), Korenok and Swanson (2005, 2007), Laforte (2007), Trabandt (2005) and the papers cited therein).

our particular estimation approach. Third, contrary to the perceived notion that the SP and SI models perform better during the 1983-2005 period (see e.g. Kiley (2007)), we suggest that such improvement is due largely to the fact that recent history is consistent with inflation having little autocorrelation. We argue that the data in this context are getting closer to the model, and the model is not getting closer to the data.

Of note is that we do not use real-time data in this paper. For a complete discussion of the relevance of real-time data in policy and related discussion, the reader is referred to Amato and Swanson (2001), Garratt *et al.* (forthcoming), and the references cited therein.

The rest of the paper is organized as follows. In Section 2 we discuss the setup, while Section 3 discusses estimation. Details of the data used are contained in Section 4, and empirical results are gathered in Section 5. Concluding remarks are given in Section 6. All proofs and derivations are gathered in appendices.

## 2 Setup

Our modeling approach follows closely that of Fuhrer and Moore (1995). More recent papers that draw heavily upon the Fuhrer and Moore approach include Sbordone (2002) and Kiley (2007). For further details, the reader is referred to either of these papers.

In summary, we begin by estimating an unrestricted vector autoregression (VAR) model for (i) inflation, (ii) a given inflationary pressure measure, (iii) output, and (iv) interest rates, using maximum likelihood.<sup>7</sup> Then we replace the reduced form equation for inflation with a new-Keynesian structural equation. Holding the rest of the system fixed<sup>8</sup>, we proceed to estimate parameters of the structural equation by maximizing the appropriate restricted likelihood function. The space of parameters over which we maximize the likelihood is restricted to those that produce a unique rational expectations solution. In particular, we begin with a reduced form VAR model, say:

$$Z_t = A(L)Z_{t-1} + w_t, \quad Z_t = (\pi_t, g_t, \Delta y_t, r_t)',$$

where  $\pi_t$  is a measure of inflation,  $g_t$  is a measure of inflationary pressure,  $\Delta y_t$  is the growth rate of real output,  $r_t$  is the nominal short-term interest rate,  $A(L)$  is a polynomial coefficient matrix in

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<sup>7</sup>We opted for incorporating output into VAR as it is an important determinant for two out of the three measures of inflationary pressure that we investigate. Our results change little when we estimated reduced form VAR that includes only the output gap, but not output growth.

<sup>8</sup>In addition to keeping VAR parameters fixed, we later estimated all parameters simultaneously. However, as results were very similar, the parameter estimates reported on and discussed in the sequel are based on the approach discussed above. Complete results are available upon request from the authors.

the lag operator,  $L$ , and  $w_t$  is a conformably defined vector error term. Now, the only additional structure placed upon the economy is the form of the inflation equation; which replaces the reduced form inflation equation and is derived from one of the following three price models:

*I. Sticky Price Model:* Every period a fraction of firms,  $(1 - \theta_1)$ , can set a new price, independent of the past history of price changes. This price setting rule implies that the expected time between price changes is  $\frac{1}{1-\theta_1}$ . The rest of firms that cannot set their prices optimally keep last periods' price  $P_t(i) = P_{t-1}(i)$ .

*II. Sticky Price Model with Indexation:* As in the SP model, in the model with dynamic indexation only a proportion of firms  $(1 - \theta_2)$  can reset their prices during the current period. But, instead of keeping last periods' price, the rest of firms set their price proportional to the current level of inflation  $P_t(i) = \pi_t P_{t-1}(i)$ .<sup>9</sup>

*III. Sticky Information Model:* Unlike sticky price or sticky price with indexation model, in the sticky information model firms reset prices every period. But, only a fraction of firms  $(1 - \theta_3)$  use current information in pricing decisions. The rest of firms use past or outdated information when they set their prices.

In all three models the fact that a fraction of firms is not able to adjust prices optimally implies a difference between the actual  $y_t$  and the potential (natural)  $y_t^n$  level of output. We denote this difference by  $y_t^g = y_t - y_t^n$ , and refer to it as the output gap. Now, assuming zero steady state inflation, solving the associated optimization problems, and using a log-linear transformation, we can write expressions for the new-Keynesian Phillips curve for each model.<sup>10</sup> The dynamics of inflation in the sticky price model follows:

$$(SP) \quad \pi_t = \beta E_t \pi_{t+1} + \lambda_1 y_t^g + v_t, \quad (1)$$

where  $\lambda_1 = \frac{(1-\theta_1)(1-\beta\theta_1)\mu}{\theta_1}$ ,  $\mu = \frac{\omega+\sigma}{1+\varepsilon\omega}$  and  $v_t$  is a structural shock to the Phillips Curve which can be interpreted as a cost-push shock (see Galí and Gertler (1999) or Fuhrer (2006) for further details on interpretation). In the sticky price model with indexation, the equation for inflation dynamics follows:

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<sup>9</sup>In order to assess the robustness of our findings, we replaced the full indexation sticky price model with the partial indexation model of Galí and Gertler (1999). In this model, only a fraction of firms that cannot set their prices optimally correct the previous period price using last period's inflation rate; while the rest keep their prices fixed. All of our empirical findings are qualitatively the same under this alternative setup. Results are available upon request from the authors.

<sup>10</sup>For a detailed derivation of the new-Keynesian Phillips curve in the sticky price models see Woodford (2003b). For a detailed derivation of the Phillips curve in the sticky information model see Khan and Zhu (2006).

$$(SPI) \quad \pi_t = \frac{1}{1+\beta} \pi_{t-1} + \frac{\beta}{1+\beta} E_t \pi_{t+1} + \frac{\lambda_2}{1+\beta} y_t^g + v_t, \quad (2)$$

where  $\lambda_2 = \frac{(1-\theta_2)(1-\beta\theta_2)\mu}{\theta_2}$ . Finally, in the sticky information model, dynamics of inflation follows:

$$(SI) \quad \pi_t = \frac{(1-\theta_3)\xi}{\theta_3} y_t^g + (1-\theta_3) \sum_{k=0}^{\infty} E_{t-k-1} \theta_3^k (\pi_t + \xi \Delta y_t^g) + v_t. \quad (3)$$

We investigate three alternative measures of inflationary pressure including the output gap, labor share and unemployment. Equations (1)-(3) are derived under the assumption of a positive linear relation between labor share and the theoretical measure of the output gap; an assumption that holds in the standard model without variable capital.<sup>11</sup> Note that Okun's law postulates proportionality, and a negative linear relation between the output gap and unemployment. Such proportionality allows us to investigate more general versions of (1)-(3) where we substitute the output gap  $y_t^g$  with  $g_t$ , where  $g_t$  is either the output gap, labor share, or (negative) unemployment.

Given the above setup, our approach is to form a final model from one of the alternative structural equations for inflation (i.e. (1), (2) or (3)) and reduced form equations for the measure of inflationary pressure, the growth rate of real output, and the nominal interest rate from the unconstrained VAR model. This gives us  $m = 4$  equations. Namely:

$$\begin{aligned} \pi_t^{(i)} &= f^{(i)}(g_t, \pi_{t-1}, E_t \pi_{t+1}, E_{t-j} \pi_t, v_t), \quad i = 1, 2, 3, \quad j = 1, 2, \dots \\ \tilde{Z}_t &= \tilde{A}(L) Z_{t-1} + \tilde{w}_t, \end{aligned} \quad (4)$$

where  $\tilde{Z}_t = [g_t, \Delta y_t, r_t]$  is a  $m - 1 \times 1$  vector,  $\tilde{A}(L) = A(L)_{2..m}$ , is a  $(m - 1) \times m$  matrix of all rows of  $A(L)$  except the first one,  $\tilde{w}_t = [w_{2t}, w_{3t}, w_{4t}]'$ , and  $f^{(i)}$  denotes one of the three structural equations for inflation. The system is solved using the Sims (2002) algorithm that determines existence and the uniqueness of the solution, and parameters are estimated using the Kalman filter (see Appendix A in the working paper version of this piece for further details).

### 3 Data

We consider quarterly variables including real GDP, unit labor costs, the output gap, unemployment, population, the GDP deflator, and short-term interest rates for the period 1960.1-2005.4 reported in

<sup>11</sup>See Sbordone (2002) for a detailed discussion of the proportionality between labor share and the output gap.



OECD Economic Outlook 77 database.<sup>12</sup> The countries in our sample include Australia, Canada, Finland, France, the United Kingdom, Ireland, Italy, Japan, the Netherlands, Norway, New Zealand, Sweden, and the United States. Of note is that the sample sizes used vary according to country, and according to inflationary pressure measure used.<sup>13</sup> We use logged data and remove the mean from all series prior to estimation.

Summary statistics for inflation across the different countries are given in Table 1. Noteworthy observations from this table are that means and standard deviations increase in the 1970s, and fall steadily thereafter, as has been well documented. Further, there appears little evidence of fat tails (relative to normal), there is positive skewness, and there is relatively substantive positive autocorrelation across all countries except Sweden. Furthermore, while the cross country evidence suggests that the countries are quite similar with respect to various estimates of mean and standard error, there is some disparity with respect to kurtosis and first order autocorrelation magnitudes. For example, autocorrelations range from negative to positive and close to unity. However, 10 of 13 countries exhibit autocorrelations in excess of 0.59 when the entire sample period is used. Finally, and again perhaps as expected, the degree of persistence varies greatly from decade to decade, except in the United States, where persistence remains very high regardless of sample period used. Following the literature, we estimate our models using both the full sample and the 1983-2005 sample. The reader is referred to Kiley (2007) for motivation of this sub-sample, and comments on estimation robustness across sample periods.

## 4 Empirical Findings

In this section we discuss parameters estimates and evaluate the performance of the alternative models using various measures of in-sample fit, including residual autocorrelation, volatility, and simulated distributional accuracy.

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<sup>12</sup>See [www.sourceoecd.org](http://www.sourceoecd.org).

<sup>13</sup>Samples for models using the output gap have the following start dates: Australia - 1970.1, Canada - 1966.1, Finland - 1975.4, France - 1971.1, the United Kingdom - 1970.1, Ireland - 1978.2, Italy - 1971.1, Japan - 1975.1, Netherlands - 1971.4, Norway - 1979.1, New Zealand - 1979.4, Sweden - 1982.1, and the United States - 1964.2. Samples for models using labor share have the following start dates: Australia - 1968.1, Canada - 1961.1, Finland - 1970.1, France - 1970.1, the United Kingdom - 1969.1, Ireland - 1975.1, Italy - 1971.1, Japan - 1969.1, Netherlands - 1969.1, Norway - 1979.1, New Zealand - 1986.2, Sweden - 1982.1, and the United States - 1960.1. Samples for models using unemployment have the following start dates: Australia - 1968.1, Canada - 1961.1, Finland - 1970.1, France - 1970.1, the United Kingdom - 1969.1, Ireland - 1975.1, Italy - 1971.1, Japan - 1969.1, Netherlands - 1960.1, Norway - 1979.1, New Zealand - 1974.1, Sweden - 1982.1, and the United States - 1960.1.

## 4.1 Parameters

We follow the standard approach in the literature of fixing  $\beta = 0.99$ .<sup>14</sup> Thus, we estimated two parameters ( $\lambda_1$  and  $\sigma_v$ ) in the sticky price model; two parameters ( $\lambda_2$  and  $\sigma_v$ ) in the sticky price model with indexation; and three parameters ( $\xi$ ,  $\theta_3$ , and  $\sigma_v$ ) in the sticky information model.

Parameter estimates are contained in Tables 2-4. Turning first to the US estimates (see rows 13 and 26 of Tables 2-4), note that estimated coefficients associated with each of our three measures of inflationary pressure is small in magnitude (e.g. for the SI and SPI models values are almost always below 0.02 in absolute value, regardless of measure and sample period). This conforms with the findings of Fuhrer (2006) and Gali and Gertler (1999).<sup>15</sup>

Kurmann (2007) suggests that imposing uniqueness restrictions could lead to bias in parameter estimates. In particular, he shows that when the labor share is used as the measure of inflationary pressure, the estimates differ. Given this concern, we used the Fukac and Pagan (forthcoming) 2SLS methodology to correct for bias, and still found comparable or smaller coefficients, many of which ceased to be significant.

For several models/measures we reject the theoretical new-Keynesian Phillips curve because we find significant negative coefficients associated with our measures of inflationary pressure. A negative estimate means that an increase in inflationary pressures leads to a decline in inflation. In particular, we find significant negative coefficients in the sticky price model (full sample estimation period) for the coefficients associated with the output gap and unemployment, and in the sticky price model (1983-2005 sample) for the coefficient on unemployment. In the sticky information model the coefficient on the output gap is also significant and negative. This result echoes the finding of Rudd and Whelan (2007) that the coefficient on the output gap is negative. However, for the SP and SI models, the labor share usually has a significant positive coefficient associated with it, while the SPI model does not. This finding corresponds to the results of Gali and Gertler (1999), Rudd and Whelan (2007), and Kiley (2007).

Results for the other 12 countries in our sample are quite similar to those for the U.S. In particular, coefficients associated with our measures of inflationary pressure are generally small. Additionally, significant positive coefficients are not found when the output gap is used, although they are found in various cases when the labor share is used, with the exception of the SPI model, which appears to

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<sup>14</sup>We tried to estimate  $\beta$  using constrained and unconstrained maximization. However, unconstrained estimates of  $\beta$  are very far from any reasonable range, while constrained estimates are often at the boundaries.

<sup>15</sup>Coefficients are generally sufficiently small in magnitude so as to ensure that large changes in our measures of inflationary pressure produce only small changes of inflation.

be rejected almost always when the incidence of a significant positive coefficient is used as a form of specification test.

In summary, when used in conjunction with the SP model, the output gap yield frequent rejection of the model, based on the incidence of significant negative coefficients, while labor share results in a failure to reject in many cases, with the notable exception of the SPI model.

## 4.2 Residual Autocorrelation Analysis

Turning first to the U.S., note that Figure 1 reports fitted (predicted by the model) and historical (observed or “realized”) inflation and associated residuals for the full sample and the reduced sample from 1983-2005. For expository purposes, we add the mean back to the fitted values, and we convert quarterly changes into yearly. Note that we report only on the output gap; results for other measures of inflationary pressure are qualitatively the same. A number of conclusions emerge, upon inspection of the figure.

First, SP and SI models yield very similar (in-sample) predictions, but both are far from accurate.<sup>16</sup> It is immediate from inspection of the lower plots in Figure 1 that estimated residuals from SP and SI models move together with inflation both in the full and reduced samples. This is quite surprising. Indeed, inspection of the plots for the smaller more recent sub-sample suggests that any perceived improvement in fit of the SP and SI models stems simply from the fact that inflation does not deviate much from its mean, i.e. note that the SP and SI models’ residuals are essentially indistinguishable from de-measured inflation.

Table 5 reports estimated first order autocorrelations for the residuals from the models. The SP and SI models have positive, significant autocorrelations that are close to U.S. estimates of autocorrelation for inflation from Table 1. In addition, the estimates decrease in the reduced sample; in a similar way that inflation autocorrelations decrease. This is as expected, given the results presented in Figure 1. Note also that our results are in line with those of Kiley (2007), who reports that residual autocorrelation for the SP and SI models decline during the 1983-2006 subsample. Also, Fuhrer and Moore (1995) report a similar result. Interestingly, the SPI model residuals have significant negative autocorrelation. This suggests a kind of “overshooting”, in the sense that will be made clear in Table 6, where it is shown that the SPI model generates excessive autocorrelation, even in periods when historical autocorrelation is low. Evidently, none of our models are yielding white noise residuals.

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<sup>16</sup>Of note is that our results in top left plot of Figure 1 for the SP model are similar to those presented in Figure 2 in Rudd and Whelan (2007), and for the SPI model they are similar to those presented in Figure 2 in Gali and Gertler (1999).

Turning now to the other 12 countries in our sample, it should be emphasized that all of the above conclusions are robust with respect to the other countries.<sup>17,18</sup>

### 4.3 Theoretical Autocorrelation

Given MLE estimates of the structural parameters, we can calculate the autocorrelation of inflation in our theoretical models (see Appendix B in the working paper version of this piece for further details). Results are gathered in Table 6 for the 2 sub-samples. Note that due to differences in available data for the GDP deflator and other series, results are not comparable to results in Table 1. To facilitate comparison with the dynamics of historical inflation, we report historical autocorrelations for the estimation period (see second column of the table). Various conclusions emerge from inspection of this table. First, and as discussed above, persistence is pervasive across countries. Autocorrelation is generally positive and significant for both samples, historically, and is above 60% for 10 of 13 countries in the full sample, for example. In the 1983-2005 sample (i.e. the smaller sample) it is above 30% for 8 of 13 countries. The SP and SI models fall short of reproducing historical autocorrelation of inflation. This finding corresponds to that of Fuhrer and Moore (1995), who emphasize the problems the SP model has in matching historical U.S. autocorrelation, and Fuhrer(2006) points out that small autocorrelation in the SP model is not surprising, given that estimates on the coefficient associated with the measure of inflationary pressure are small, and given that in the theoretical model, all inflation autocorrelation comes from autocorrelation associated with the measure of inflationary pressure. Indeed, even if autocorrelation for the measure is high, a small coefficient still implies that almost zero autocorrelation feeds through to inflation (as discussed above). Finally, observe that SPI autocorrelation is significant and positive for all cases. However, as pointed out above in a different context, the theoretically implied SPI autocorrelation is actually higher than the autocorrelation calculated using the historical

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<sup>17</sup>Figures for the other 13 countries in our sample have been compiled, and are given in working paper versions of the paper, or upon request from the authors.

<sup>18</sup>Following the suggestion of an anonymous referee, we also estimated the open economy version of the Phillips curve derived in Gali and Monacelli (2005):

$$\pi_t = \beta E_t \pi_{t+1} + \lambda_1 y_t^g + \alpha \Delta s_t - \alpha \beta E_t \Delta s_{t+1} + v_t,$$

where  $\alpha$  is the share of domestic consumption allocated to import goods, and  $s_t$  is the terms of trade variable. We obtained terms of trade data from the DRI (Global Insight) International Database. In particular the series TOTNS (Australia, Ireland, Japan, Norway, New Zealand, Sweden, and United Kingdom) and TOT (Canada) were converted to log differences to obtain growth rates. Given that the terms of trade enters the Phillips curve, we also added it to our VAR vector of variables,  $Z_t^{open} = (\pi_t, \Delta s_t, g_t, \Delta y_t, r_t)'$ .

Even though point estimates of the coefficients on measures of inflationary pressure do change, the in-sample fit of the open economy Phillips curve model is quite close to the in-sample fit of the closed economy Phillips curve models. The estimates of structural parameters for the sticky price open economy model and comparisons of the fit for Canada, Japan, the U.K., and New Zealand are given in working paper version of the paper. Our results with regard to residual autocorrelation carry over to virtually all of the countries in our sample.

data. Indeed, even in cases where the historical autocorrelation is close to zero, autocorrelation implied by the SPI model is around 80-90%.

#### 4.4 Point Measures of Fit

The ratio of fitted and historical inflation standard errors is reported for the different countries and inflationary pressure measures in Panels A and B of Table 7. Of note is that fitted inflation in the SP and SI models has very low variability, while fitted inflation from the SPI model has variability that is close to historical levels, regardless of sub-sample used (compare Panels A and B in the table). Indeed, inflation standard errors implied by the SP and SI models are often as little as one third the magnitude of their historical counterparts. For example, the ratio is less than 0.30 for the SP model in 11 of 13 countries when the output gap is used, 10 of 13 countries when labor share is used, and 9 of 13 countries when unemployment is used, when models are estimated using the full sample of data. Results are similar based upon the reduced sample. On the other hand, the SPI model yield inflation standard errors within 10% of historical levels for 13 of 13 countries when the output gap is used, 7 of 13 countries when labor share is used, and 12 of 13 countries when unemployment is used, when models are estimated using the full sample of data. Again, results are similar based upon the reduced sample.

Root mean square error (RMSE) of the fitted models is reported for the different countries and inflationary pressure measures in Panels C and D of Table 7. Of note is that although the SPI model generally yields lower RMSE when the entire sample is used, this is not so when the 1983-2005 estimation period is used. In particular, RMSE is usually lower for the SP and SI models when the shorter sub-sample is used for estimation. While this result may appear to be contradictory with the results of Panels A and B of the table, it is not, as there is negative autocorrelation in the residuals coupled with an autoregressive model structure. This is a shortcoming of the SPI model, as is the same problem discussed above concerning too much persistence in the SPI model. However, it should be noted that using only RMSE to select the “best” model, hence resulting in the choice of either the SP or SI model in the recent sub-sample, completely ignores the feature of the SP and SI models that the errors of these models are highly correlated. Our evidence based Tables 5-6 accounts largely for our recommendation that RMSE comparison could be misleading, and should be used with caution. Indeed, in the following sub-section we present formal evidence based upon the CS distributional accuracy test that the SP and SI models are not outperforming the SPI model, even during the 1983-2005 period.

## 4.5 Distributional Accuracy

Assume that there exists a joint distribution of inflation and lagged inflation implied by our different dynamic models, all of which are potentially misspecified. Our objective is to compare “true” joint distributions with ones generated by given models 1, ...,  $m$ , say. This is accomplished via comparison of the empirical joint distributions (or confidence intervals) of historical and simulated time series. In particular, and following Corradi and Swanson (2005, 2007a), we are interested in testing the hypotheses that:

$$H_0 : \max_{j=2, \dots, m} \int_U E \left( \left( F_0(u; \Theta_0) - F_1(u; \Theta_1^\dagger) \right)^2 - \left( F_0(u; \Theta_0) - F_j(u; \Theta_j^\dagger) \right)^2 \right) \phi(u) du \leq 0$$

$$H_A : \max_{j=2, \dots, m} \int_U E \left( \left( F_0(u; \Theta_0) - F_1(u; \Theta_1^\dagger) \right)^2 - \left( F_0(u; \Theta_0) - F_j(u; \Theta_j^\dagger) \right)^2 \right) \phi(u) du > 0.$$

where  $F_0(u; \Theta_0)$  denotes the distribution of  $Y_t = (\pi_t, \pi_{t-1})'$  evaluated at  $u$  and  $F_j(u; \Theta_j^\dagger)$  denotes the distribution of  $Y_{j,n}(\Theta_j^\dagger)$ , where  $\Theta_j^\dagger$  is the probability limit of  $\widehat{\Theta}_{j,T}$ , taken as  $T \rightarrow \infty$ , and where  $u \in U \subset \mathfrak{R}^2$ , possibly unbounded, for  $\widehat{\Theta}_{j,T}$  our estimated parameter vector for model  $j$ . Thus, the rule is to choose Model 1 over Model 2, say, if

$$\int_U E \left( \left( F_0(u; \Theta_0) - F_1(u; \Theta_1^\dagger) \right)^2 \right) \phi(u) du < \int_U E \left( \left( F_0(u; \Theta_0) - F_2(u; \Theta_2^\dagger) \right)^2 \right) \phi(u) du,$$

where  $\int_U \phi(u) du = 1$  and  $\phi(u) \geq 0$  for all  $u \in U \subset \mathfrak{R}^2$ . For any evaluation point, this measure defines a norm and is a typical goodness of fit measure. Furthermore, by setting  $Y_t = (\pi_t, \pi_{t-1})'$  we are constructing a test of whether any of the alternative models beats the “benchmark” model (i.e. model 1). In the current context, we set the benchmark equal to SP, so that SPI and SI are the alternative models. A summary of the details involved in constructing the statistic associated with testing the above hypotheses is given in Appendix C of the working paper version of this piece. For further details, the reader is referred to Corradi and Swanson (2007a). Alternative tests based on recursive estimation techniques and point estimates rather than distributional measures are discussed in Corradi and Swanson (2007b).

Table 8 reports CS distributional loss measures (i.e.  $\frac{1}{T} \sum_{t=1}^T \left( 1\{Y_t \leq u\} - \frac{1}{S} \sum_{n=1}^S 1\{Y_{i,n}(\widehat{\Theta}_{i,T}) \leq u\} \right)^2$ ) for  $i = SP, SPI$ , and  $SI$ , which are in turn used in construction of the statistics used to test the above hypotheses. (In the preceding expression,  $S$  denotes the simulation sample size, where data are simulated according to model  $i$ , and is set equal to  $50T$  in our calculations, where  $T$  is the sample size used in estimation of the model.) Starred entries indicate cases where  $H_0$  is rejected in favor of  $H_A$  (i.e. the benchmark model is rejected in favor of at least one of the alternatives).

Two clear-cut observations can be made based upon the results reported in the table. First, note that the SPI model yields the lowest CS distributional loss (entries in bold are “lowest”) for all but 2 or 3 countries if output gap or labor share is used as the inflation pressure measure, when the full sample is used for model estimation. On the other hand, the SPI model “wins” for around one half of the countries when the shorter sub-sample is used for model estimation. Thus, contrary to our evidence based on RMSE analysis (see Table 7, Panels C and D), when the joint distribution of  $\pi_t$  and  $\pi_{t-1}$  is evaluated there is some evidence favoring the SPI model, even for the shorter sample period.

Second, the null hypothesis fails to be rejected, regardless of inflation pressure measure and sample period, a result which may in part be due to finite sample power reduction stemming from the use of our relatively small samples of historical data. Another possible reason for the failure to reject the null for any countries is illustrated in Figure 2, where a scatter plot of simulated  $\pi_t$  and  $\pi_{t-1}$  values is given. In particular, note that in the dense central region of the plot, all simulated SPI as well as historical observations are highly overlapping. Furthermore, in the bottom left quadrant of the plot, there are SPI simulated values that do not have corresponding historical counterparts. This extra mass in the negative region of the joint distribution is a result of the excess persistence of the SPI model, and in terms of CS distributional loss, may account for the failure of the SPI model to be statistically superior to the other models based upon application of the CS test. Even given the poor “left tail” performance of the SPI model, its clear dominance in all other regions of the joint distribution results in the relatively superior point CS measure performance of the SPI model discussed in the preceding paragraph, particularly when the full sample is used to estimate and compare the models. Overall, we thus again conclude that all of the models need to be improved, although this might be more easily done with the SPI model, as it is the only model that appears dynamically rich enough to capture any sort of inflation dynamics.

## 5 Concluding Remarks

Given our modelling approach, the SPI model is preferable to the SP or SI models in the sense that the SPI captures the type of strong inflationary persistence that has in the past characterized the economies of the countries in our sample. Two key caveats to this conclusion, however, are that improvement in performance is driven only by the time series part of the model (i.e. lagged inflation) and that the SPI model overemphasizes inflationary persistence. Moreover, the SPI model performs well everywhere except in the region of the joint distribution where current and lagged inflation is negative. This

problem is clearly related to excess persistence of the SPI. Finally, it should be noted that the SP model performs much better when the coefficient that multiplies labor share is fixed to be in line with the value estimated by Gali and Gertler (1999) and Sbordone (2002). Overall, we thus conclude that there appears to be room for improvement via either modified versions of *all* the above models, or via development of new models, that better “track” inflation persistence. We conjecture that this might be more easily done with the SPI model, as it is the only model that appears dynamically rich enough to capture inflation dynamics.

Two directions for future research that may be of particular interest, given our findings, are the following. First, more emphasis might be put on theories that provide theoretical justification for incorporating past inflation through learning, different expectations formation, non-zero steady state inflation, general models of price stickiness, and heterogeneity of firms’ pricing behavior (see e.g. Wolman (1999), Orphanides and Williams (2003), Sbordone and Cogley (forthcoming), and Imbs *et al.* (2007)). Second, more appropriate measures of inflationary pressure may be worth pursuing.



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**Table 1: Summary Statistics - Historical Inflation**

	AUS	CAN	FIN	FRA	UK	IRL	ITA	JPN	HOL	NOR	NZL	SWE	USA
<i>A. Mean</i>													
60-70	3.12	3.69	5.83	4.24	3.87	5.02	4.22	5.71	5.07	3.95	7.43	4.22	2.52
70-80	10.43	8.20	11.03	9.42	13.31	13.32	13.97	7.85	7.56	8.26	14.52	9.40	6.68
80-90	7.95	5.62	7.21	6.76	7.07	8.13	11.32	2.45	2.22	7.13	10.61	8.22	4.50
90-05	2.28	1.96	2.07	1.66	3.04	3.39	3.68	-0.24	2.40	3.39	1.90	2.33	2.15
60-05	5.51	4.54	5.99	5.11	6.38	6.98	7.76	3.43	4.08	5.42	7.82	5.60	3.75
83-05	3.68	2.54	3.36	2.69	3.79	3.91	5.14	0.44	1.92	3.83	4.30	3.87	2.46
<i>B. Standard Deviation</i>													
60-70	3.42	2.81	3.01	3.45	3.58	3.29	3.01	4.11	2.52	3.12	37.35	10.27	1.59
70-80	5.89	3.76	5.68	2.92	7.95	5.32	7.83	6.08	2.29	7.38	21.27	10.76	2.24
80-90	3.09	3.38	3.82	3.67	4.57	5.42	5.99	2.43	3.65	7.74	7.24	5.08	2.50
90-05	2.05	2.41	3.04	0.96	2.44	3.87	2.40	1.84	1.87	8.41	3.31	4.88	0.92
60-05	5.00	3.87	5.15	4.11	6.24	5.86	6.69	4.93	3.34	7.42	20.10	8.36	2.55
83-05	3.04	2.39	3.74	2.22	2.87	3.65	3.55	2.11	2.35	8.08	6.23	5.13	1.01
<i>C. Kurtosis</i>													
60-70	0.06	6.82	3.20	2.83	2.33	0.21	0.15	0.19	0.93	2.68	11.31	-0.37	-0.88
70-80	0.22	-0.35	1.55	-0.49	1.14	0.74	0.21	2.21	0.64	3.57	1.10	-0.61	0.36
80-90	0.57	0.01	2.40	-1.10	1.22	-0.99	0.08	1.53	-0.38	1.86	0.32	3.54	0.85
90-05	1.49	1.45	2.55	2.81	1.95	2.60	0.97	0.91	3.22	0.54	0.33	3.50	1.44
60-05	2.01	1.08	2.46	-0.60	4.05	-0.01	1.87	4.02	-0.50	1.94	26.27	0.57	0.90
83-05	-0.46	1.45	-0.04	3.21	0.32	1.77	1.34	-0.16	1.58	0.77	1.65	0.86	0.02
<i>D. Skewness</i>													
60-70	-0.24	-1.83	1.64	1.63	0.42	0.76	0.63	-0.65	-0.53	0.40	2.53	0.05	0.67
70-80	0.74	0.39	1.18	0.12	0.65	-0.14	0.53	1.52	-1.08	0.95	-0.22	-0.07	0.52
80-90	-0.23	0.85	0.05	0.47	0.94	0.44	0.83	0.91	0.15	-0.62	-0.25	1.33	1.31
90-05	0.58	-0.49	1.09	1.30	1.06	0.96	0.90	0.85	0.91	0.12	0.05	1.08	1.11
60-05	1.12	0.52	1.12	0.78	1.69	0.72	1.40	1.56	-0.01	0.15	3.07	0.40	1.18
83-05	0.46	-0.49	0.54	1.78	0.68	0.62	1.11	0.56	-0.17	-0.12	1.11	0.49	0.67
<i>E. First Order Autocorrelation</i>													
60-70	-0.03	0.13	0.84	-0.02	-0.36	0.83	0.46	-0.09	0.83	0.23	-0.20	-0.50	0.83
70-80	0.27	0.64	0.73	0.52	0.44	0.84	0.41	0.75	0.81	-0.18	-0.17	-0.36	0.65
80-90	0.33	0.71	0.11	0.85	0.49	0.96	0.68	0.26	0.29	0.25	0.19	-0.13	0.89
90-05	0.26	0.33	0.18	0.38	0.20	-0.11	0.56	0.31	0.01	0.05	-0.05	-0.08	0.46
60-05	0.59	0.70	0.72	0.80	0.61	0.79	0.74	0.69	0.67	0.12	-0.11	-0.17	0.88
83-05	0.58	0.36	0.36	0.81	0.19	0.12	0.69	0.38	0.04	0.06	0.39	0.11	0.52

Notes: Historical inflation is measured by the GDP deflator. Mean, standard deviation, kurtosis, skewness and autocorrelation summary statistics are given for the 13 countries in our dataset. All samples used end in 2005.4, are based upon quarterly data. Sample start dates vary as follows: Canada - 1961.1, France - 1963.1, New Zealand - 1961.1, and all other countries 1960.1. Country mnemonics used are: AUS - Australia, CAN - Canada, FIN - Finland, FRA - France, IRL - Ireland, ITA - Italy, JPN - Japan, HOL - Holland, NOR - Norway, NZL -New Zealand, and SWE - Sweden.

**Table 2: Parameter Estimates - Sticky Price Model**

	<i>A. Full Sample Estimation Period</i>								
	<i>Output Gap</i>			<i>Measure of Inflationary Pressure</i>			<i>Unemployment</i>		
	$\lambda_1$	$\sigma_v$	LL	$\lambda_1$	$\sigma_v$	LL	$\lambda_1$	$\sigma_v$	LL
Australia	-0.0211 (0.0065)	0.0117 (0.0007)	2616	0.0027 (0.0000)	0.0111 (0.0006)	2436	0.0036 (0.0016)	0.0120 (0.0007)	2632
Canada	-0.0052 (0.0000)	0.0090 (0.0005)	3053	0.0020 (0.0000)	0.0085 (0.0005)	3136	-0.0018 (0.0008)	0.0091 (0.0005)	3288
Finland	-0.0055 (0.0019)	0.0105 (0.0007)	2263	0.0015 (0.0000)	0.9060 (0.0000)	1833	0.0067 (0.0014)	0.0123 (0.0007)	2505
France	-0.0253 (0.0048)	0.0090 (0.0005)	2767	0.0022 (0.0000)	0.0205 (0.0000)	2566	0.0056 (0.0010)	0.0086 (0.0005)	2777
UK	-0.0177 (0.0000)	0.0139 (0.0000)	2635	0.0034 (0.0000)	0.0136 (0.0000)	2401	0.0015 (0.0015)	0.0151 (0.0008)	2589
Ireland	0.0017 (0.0030)	0.0125 (0.0008)	1870	0.0000 (0.0000)	0.0136 (0.0009)	1924	0.0005 (0.0002)	0.0141 (0.0009)	2035
Italy	-0.0309 (0.0000)	0.0136 (0.0008)	2577	0.0025 (0.0000)	0.0126 (0.0000)	2332	0.0101 (0.0023)	0.0155 (0.0009)	2467
Japan	0.0016 (0.0033)	0.0072 (0.0005)	2456	-0.0061 (0.0017)	0.0111 (0.0007)	2487	0.0092 (0.0006)	0.0089 (0.0005)	2842
Netherlands	-0.0003 (0.0030)	0.0083 (0.0005)	2543	0.0016 (0.0000)	0.0076 (0.0004)	2475	0.0029 (0.0006)	0.0072 (0.0004)	3385
Norway	-0.0039 (0.0050)	0.0199 (0.0014)	1744	-0.0316 (0.0000)	0.2441 (0.0000)	1428	0.0151 (0.0130)	0.0198 (0.0014)	1852
New Zealand	-0.0210 (0.0097)	0.0154 (0.0011)	1639	0.0034 (0.0000)	0.0111 (0.0009)	1250	0.0107 (0.0040)	0.0236 (0.0015)	2029
Sweden	-0.0118 (0.0034)	0.0114 (0.0009)	1827	-0.0102 (0.0050)	0.0120 (0.0009)	1585	-0.0028 (0.0033)	0.0122 (0.0009)	1701
US	-0.0066 (0.0000)	0.0054 (0.0000)	3218	0.0054 (0.0000)	0.0052 (0.0003)	3322	-0.0038 (0.0000)	0.0055 (0.0000)	3513
<i>B. 1983-2005 Estimation Period</i>									
Australia	-0.0149 (0.0024)	0.0062 (0.0005)	1821	0.0069 (0.0004)	0.0067 (0.0005)	1603	-0.0058 (0.0021)	0.0070 (0.0005)	1717
Canada	-0.0002 (0.0027)	0.0059 (0.0004)	1802	0.0007 (0.0003)	0.0058 (0.0004)	1699	-0.0019 (0.0016)	0.0058 (0.0005)	1768
Finland	-0.0040 (0.0014)	0.0086 (0.0006)	1725	0.0010 (0.0000)	0.0082 (0.0000)	1547	-0.0013 (0.0015)	0.0089 (0.0007)	1620
France	-0.0148 (0.0017)	0.0033 (0.0002)	1997	0.0081 (0.0008)	0.0029 (0.0002)	1813	-0.0090 (0.0021)	0.0041 (0.0003)	1877
UK	-0.0013 (0.0036)	0.0068 (0.0005)	1810	0.0032 (0.0000)	0.0067 (0.0000)	1672	-0.0020 (0.0000)	0.0064 (0.0000)	1775
Ireland	0.0000 (0.0020)	0.0086 (0.0006)	1568	0.0000 (0.0001)	0.0086 (0.0006)	1447	0.0007 (0.0001)	0.0092 (0.0007)	1554
Italy	-0.0178 (0.0022)	0.0058 (0.0004)	1895	0.0037 (0.0004)	0.0058 (0.0004)	1647	-0.0098 (0.0022)	0.0067 (0.0005)	1730
Japan	0.0047 (0.0003)	0.0048 (0.0004)	1880	-0.0104 (0.0021)	0.0040 (0.0003)	1745	0.0048 (0.0000)	0.0066 (0.0000)	1883
Netherlands	0.0014 (0.0013)	0.0057 (0.0004)	1842	-0.0010 (0.0014)	0.0058 (0.0005)	1706	0.0036 (0.0009)	0.0054 (0.0004)	1811
Norway	0.0003 (0.0046)	0.0197 (0.0015)	1489	-0.0004 (0.0014)	0.0198 (0.0015)	1402	0.0080 (0.0123)	0.0197 (0.0015)	1581
New Zealand	-0.0119 (0.0073)	0.0142 (0.0010)	1458	0.0034 (0.0000)	0.0111 (0.0009)	1250	-0.0056 (0.0034)	0.0141 (0.0010)	1511
Sweden	-0.0117 (0.0037)	0.0115 (0.0009)	1767	-0.0128 (0.0054)	0.0117 (0.0008)	1527	-0.0042 (0.0036)	0.0121 (0.0009)	1637
US	0.0049 (0.0000)	0.0024 (0.0002)	1921	0.0097 (0.0000)	0.0021 (0.0002)	1803	-0.0080 (0.0020)	0.0023 (0.0002)	1930

Notes: Parameters are estimated by maximum likelihood (for details see Appendix A). Standard errors for parameter estimates are given in parentheses. Standard errors are taken from the inverted Hessian of a log-likelihood function.  $\lambda_1$  is the coefficient that multiplies the measure of inflationary pressure in the sticky price model,  $\sigma_v$  is the standard deviation of the structural error term, and LL denotes the maximum value of the log-likelihood function over the parameter range.

**Table 3: Parameter Estimates - Sticky Price with Indexation Model**

	<i>A. Full Sample Estimation Period</i>								
	<i>Measure of Inflationary Pressure</i>								
	<i>Output Gap</i>			<i>Labor Share</i>			<i>Unemployment</i>		
	$\lambda_2$	$\sigma_v$	LL	$\lambda_2$	$\sigma_v$	LL	$\lambda_2$	$\sigma_v$	LL
Australia	-0.0153 (0.0086)	0.0054 (0.0004)	2634	-0.0045 (0.0025)	0.0056 (0.0004)	2447	0.0030 (0.0019)	0.0053 (0.0003)	2649
Canada	0.0047 (0.0025)	0.0034 (0.0002)	3102	-0.0017 (0.0011)	0.0038 (0.0002)	3163	0.0026 (0.0016)	0.0038 (0.0002)	3328
Finland	-0.0052 (0.0031)	0.0056 (0.0004)	2260	-0.0022 (0.0014)	0.0053 (0.0003)	2404	-0.0020 (0.0016)	0.0052 (0.0003)	2533
France	0.0018 (0.0016)	0.0022 (0.0001)	2862	-0.0011 (0.0008)	0.0024 (0.0001)	2721	0.0013 (0.0008)	0.0024 (0.0001)	2861
UK	0.0094 (0.0055)	0.0065 (0.0004)	2653	-0.0055 (0.0032)	0.0066 (0.0004)	2422	0.0043 (0.0026)	0.0064 (0.0004)	2619
Ireland	0.0114 (0.0062)	0.0056 (0.0004)	1891	-0.0004 (0.0003)	0.0051 (0.0004)	1963	0.0020 (0.0014)	0.0052 (0.0003)	2077
Italy	0.0049 (0.0039)	0.0058 (0.0004)	2600	-0.0008 (0.0007)	0.0059 (0.0004)	2343	0.0015 (0.0013)	0.0057 (0.0003)	2505
Japan	-0.0033 (0.0027)	0.0030 (0.0002)	2480	-0.0044 (0.0020)	0.0039 (0.0002)	2549	-0.0008 (0.0008)	0.0037 (0.0002)	2867
Netherlands	-0.0049 (0.0036)	0.0038 (0.0002)	2557	-0.0024 (0.0015)	0.0038 (0.0002)	2488	0.0020 (0.0011)	0.0034 (0.0002)	3401
Norway	0.0138 (0.0086)	0.0135 (0.0009)	1716	-0.0007 (0.0007)	0.0130 (0.0008)	1611	-0.0245 (0.0178)	0.0134 (0.0009)	1823
New Zealand	-0.0235 (0.0138)	0.0087 (0.0007)	1631	-0.0103 (0.0060)	0.0079 (0.0006)	1229	-0.0128 (0.0085)	0.0153 (0.0010)	1999
Sweden	-0.0166 (0.0101)	0.0086 (0.0007)	1796	-0.0445 (0.0195)	0.0092 (0.0007)	1562	-0.0180 (0.0100)	0.0086 (0.0006)	1676
US	0.0026 (0.0015)	0.0016 (0.0001)	3316	-0.0010 (0.0008)	0.0015 (0.0001)	3422	0.0028 (0.0014)	0.0015 (0.0001)	3630
	<i>B. 1983-2005 Estimation Period</i>								
Australia	0.0016 (0.0017)	0.0034 (0.0002)	1811	-0.0027 (0.0025)	0.0034 (0.0003)	1600	-0.0104 (0.0063)	0.0036 (0.0003)	1720
Canada	-0.0116 (0.0065)	0.0035 (0.0003)	1791	-0.0012 (0.0010)	0.0034 (0.0003)	1686	0.0008 (0.0009)	0.0033 (0.0002)	1752
Finland	-0.0063 (0.0035)	0.0054 (0.0004)	1711	-0.0022 (0.0015)	0.0053 (0.0004)	1530	-0.0063 (0.0037)	0.0054 (0.0004)	1609
France	-0.0038 (0.0026)	0.0017 (0.0001)	1998	0.0016 (0.0013)	0.0016 (0.0001)	1801	-0.0012 (0.0013)	0.0016 (0.0001)	1897
UK	0.0064 (0.0048)	0.0044 (0.0004)	1788	-0.0150 (0.0087)	0.0047 (0.0004)	1653	0.0023 (0.0019)	0.0044 (0.0003)	1747
Ireland	0.0146 (0.0085)	0.0062 (0.0005)	1544	-0.0011 (0.0008)	0.0060 (0.0005)	1421	0.0018 (0.0014)	0.0060 (0.0005)	1535
Italy	-0.0064 (0.0053)	0.0034 (0.0002)	1883	-0.0010 (0.0008)	0.0033 (0.0002)	1638	-0.0103 (0.0064)	0.0034 (0.0002)	1733
Japan	-0.0041 (0.0032)	0.0030 (0.0002)	1861	-0.0203 (0.0103)	0.0032 (0.0003)	1715	-0.0056 (0.0041)	0.0030 (0.0002)	1867
Netherlands	-0.0147 (0.0079)	0.0043 (0.0003)	1815	-0.0036 (0.0030)	0.0041 (0.0003)	1675	-0.0053 (0.0037)	0.0041 (0.0003)	1776
Norway	0.0089 (0.0079)	0.0138 (0.0010)	1460	-0.0004 (0.0004)	0.0134 (0.0010)	1370	-0.0435 (0.0288)	0.0141 (0.0011)	1554
New Zealand	0.0057 (0.0058)	0.0077 (0.0006)	1449	-0.0103 (0.0060)	0.0079 (0.0006)	1229	0.0012 (0.0011)	0.0076 (0.0006)	1498
Sweden	-0.0205 (0.0122)	0.0088 (0.0007)	1736	-0.0551 (0.0211)	0.0094 (0.0008)	1502	-0.0216 (0.0118)	0.0088 (0.0007)	1612
US	-0.0075 (0.0045)	0.0013 (0.0001)	1922	-0.0014 (0.0014)	0.0012 (0.0001)	1790	0.0019 (0.0021)	0.0012 (0.0001)	1922

Notes: See notes to Table 2.  $\lambda_2$  is the coefficient that multiplies the measure of inflationary pressure in the sticky price with indexation model.

**Table 4: Parameter Estimates - Sticky Information Model**

*A. Full Sample Estimation Period*

	<i>Measure of Inflationary Pressure</i>											
	<i>Output Gap</i>				<i>Labor Share</i>				<i>Unemployment</i>			
	$\theta_3$	$\xi$	$\sigma_v$	LL	$\theta_3$	$\xi$	$\sigma_v$	LL	$\theta_3$	$\xi$	$\sigma_v$	LL
Australia	0.5310 (0.0381)	-0.0007 (0.0037)	0.0121 (0.0007)	2611	0.5520 (0.0332)	0.0062 (0.0022)	0.0099 (0.0006)	2454	0.4845 (0.0399)	0.0030 (0.0021)	0.0109 (0.0006)	2646
Canada	0.4419 (0.0934)	0.0002 (0.0007)	0.0093 (0.0005)	3050	0.7369 (0.0493)	0.0518 (0.0274)	0.0086 (0.0004)	3135	0.4501 (0.1169)	0.0004 (0.0010)	0.0092 (0.0006)	3288
Finland	0.5246 (0.0768)	0.0002 (0.0013)	0.0108 (0.0007)	2258	0.5727 (0.0304)	0.0032 (0.0009)	0.0126 (0.0004)	2372	0.5720 (0.0184)	0.0093 (0.0015)	0.0107 (0.0006)	2526
France	0.5073 (0.0506)	0.0008 (0.0009)	0.0102 (0.0006)	2751	0.8636 (0.0193)	0.3876 (0.0896)	0.0083 (0.0004)	2635	0.4765 (0.0095)	0.0031 (0.0007)	0.0062 (0.0004)	2820
UK	0.8103 (0.1051)	-0.0602 (0.0233)	0.0152 (0.0009)	2624	0.5438 (0.0174)	0.0076 (0.0014)	0.0120 (0.0007)	2423	0.6148 (0.0318)	0.0197 (0.0052)	0.0140 (0.0007)	2600
Ireland	0.6278 (0.0655)	0.0110 (0.0047)	0.0123 (0.0008)	1872	0.4591 (0.0266)	0.0000 (0.0000)	0.0137 (0.0010)	1924	0.5211 (0.0306)	0.0013 (0.0005)	0.0138 (0.0009)	2037
Italy	0.6921 (0.0228)	-0.1185 (0.0064)	0.0154 (0.0011)	2561	0.5232 (0.0216)	0.0038 (0.0012)	0.0102 (0.0006)	2358	0.4834 (0.0215)	0.0064 (0.0025)	0.0110 (0.0005)	2512
Japan	0.5668 (0.1604)	0.0022 (0.0032)	0.0072 (0.0005)	2457	0.5657 (0.0250)	-0.0060 (0.0010)	0.0108 (0.0007)	2488	0.5572 (0.0090)	0.0242 (0.0020)	0.0093 (0.0005)	2835
Netherlands	0.4820 (0.0628)	0.0013 (0.0018)	0.0081 (0.0004)	2545	0.6777 (0.0331)	0.0205 (0.0074)	0.0072 (0.0004)	2484	0.4405 (0.0518)	0.0010 (0.0011)	0.0066 (0.0003)	3399
Norway	0.7372 (0.0376)	0.0890 (0.0065)	0.0196 (0.0013)	1746	0.5022 (0.0172)	0.0016 (0.0013)	0.0197 (0.0013)	1643	0.9747 (0.0520)	0.2314 (0.0161)	0.0198 (0.0016)	1852
New Zealand	0.9992 (0.0336)	-0.0888 (0.0000)	0.0159 (0.0013)	1637	0.7560 (0.1615)	-0.0012 (0.0015)	0.0118 (0.0010)	1246	0.5749 (0.0203)	0.0213 (0.0040)	0.0218 (0.0011)	2038
Sweden	0.9573 (0.3772)	-0.0166 (0.0133)	0.0122 (0.0009)	1820	1.0000 (1.3888)	0.0407 (0.1085)	0.0121 (0.0009)	1582	0.5228 (0.0729)	0.0041 (0.0072)	0.0114 (0.0006)	1705
US	0.6949 (0.0548)	-0.0233 (0.0079)	0.0059 (0.0003)	3206	0.5390 (0.0110)	0.0079 (0.0010)	0.0049 (0.0003)	3335	0.4376 (0.0690)	-0.0006 (0.0005)	0.0059 (0.0003)	3504

*B. 1983-2005 Estimation Period*

Australia	0.6230 (0.0711)	-0.0173 (0.0097)	0.0070 (0.0004)	1811	0.4658 (0.0334)	0.0034 (0.0023)	0.0065 (0.0005)	1604	0.8547 (8.3394)	0.0018 (0.0585)	0.0073 (0.0006)	1713
Canada	0.7758 (0.0861)	0.0726 (0.0462)	0.0058 (0.0004)	1803	0.4989 (0.1255)	0.0003 (0.0008)	0.0059 (0.0005)	1698	0.8637 (0.8984)	0.0019 (0.0052)	0.0059 (0.0006)	1767
Finland	0.5208 (0.0486)	0.0001 (0.0005)	0.0089 (0.0006)	1722	0.5522 (0.1025)	0.0016 (0.0020)	0.0085 (0.0007)	1545	0.6179 (0.1418)	0.0035 (0.0042)	0.0086 (0.0006)	1621
France	0.8569 (0.0413)	-0.4025 (0.1593)	0.0043 (0.0003)	1974	0.5884 (0.0309)	0.0108 (0.0035)	0.0035 (0.0003)	1793	0.4051 (0.2751)	0.0003 (0.0027)	0.0046 (0.0003)	1867
UK	0.4937 (0.0589)	0.0021 (0.0019)	0.0066 (0.0006)	1814	0.5741 (0.2281)	0.0018 (0.0036)	0.0069 (0.0005)	1671	0.5007 (0.1279)	-0.0013 (0.0024)	0.0068 (0.0006)	1772
Ireland	0.5242 (0.4613)	0.0003 (0.0049)	0.0086 (0.0006)	1568	0.5500 (0.0335)	-0.0001 (0.0002)	0.0086 (0.0007)	1447	0.5076 (0.0501)	0.0012 (0.0009)	0.0089 (0.0007)	1557
Italy	0.7998 (0.0415)	-0.3991 (0.1957)	0.0069 (0.0005)	1878	0.5494 (0.1700)	0.0033 (0.0063)	0.0065 (0.0012)	1639	0.5244 (0.3735)	-0.0001 (0.0005)	0.0079 (0.0006)	1714
Japan	0.8318 (0.0672)	0.2409 (0.1715)	0.0048 (0.0003)	1878	0.7789 (0.0201)	-0.2490 (0.0171)	0.0044 (0.0003)	1736	0.6516 (0.0691)	0.0362 (0.0221)	0.0042 (0.0003)	1895
Netherlands	0.5477 (0.0688)	0.0054 (0.0051)	0.0054 (0.0005)	1846	0.5894 (0.0746)	-0.0060 (0.0043)	0.0057 (0.0004)	1706	0.5599 (0.4238)	0.0043 (0.0151)	0.0054 (0.0006)	1811
Norway	0.9307 (0.0321)	0.0944 (0.0068)	0.0196 (0.0017)	1489	0.9933 (0.0521)	-0.0142 (0.0046)	0.0197 (0.0017)	1402	0.9909 (0.0612)	0.2638 (0.0271)	0.0198 (0.0014)	1581
New Zealand	0.8933 (0.2058)	0.0568 (0.0276)	0.0144 (0.0010)	1457	0.7560 (0.1615)	-0.0012 (0.0015)	0.0118 (0.0010)	1246	0.6635 (0.0821)	0.0232 (0.0111)	0.0141 (0.0010)	1511
Sweden	0.9460 (0.3372)	-0.0185 (0.0141)	0.0122 (0.0009)	1760	0.9280 (0.5202)	-0.0102 (0.0103)	0.0120 (0.0009)	1522	0.5655 (0.0662)	0.0076 (0.0052)	0.0115 (0.0009)	1641
US	0.6021 (0.0503)	0.0187 (0.0114)	0.0022 (0.0002)	1927	0.5952 (0.0340)	0.0126 (0.0047)	0.0022 (0.0002)	1798	0.8952 (0.0382)	-0.5188 (0.4105)	0.0024 (0.0002)	1927

Notes: See notes to Table 2.  $\xi$  is the coefficient that multiplies the measure of inflationary pressure in the sticky information model and  $\theta_3$  is the fraction of firms that make pricing decisions based on past information.

**Table 5: Residual Autocorrelations Based on the Three Theoretical Models**

<i>A. Full Sample Estimation Period</i>									
<i>Measure of Inflationary Pressure</i>									
	<i>Output Gap</i>			<i>Labor Share</i>			<i>Unemployment</i>		
	SP	SPI	SI	SP	SPI	SI	SP	SPI	SI
Australia	0.61*	-0.40*	0.63*	0.55*	-0.42*	0.42*	0.58*	-0.45*	0.49*
Canada	0.71*	-0.33*	0.73*	0.62*	-0.32*	0.62*	0.67*	-0.33*	0.68*
Finland	0.44*	-0.47*	0.48*	0.66*	-0.43*	0.67*	0.64*	-0.43*	0.53*
France	0.86*	-0.31*	0.89*	0.86*	-0.33*	0.85*	0.83*	-0.34*	0.72*
UK	0.59*	-0.43*	0.65*	0.61*	-0.39*	0.45*	0.65*	-0.42*	0.59*
Ireland	0.63*	-0.54*	0.62*	0.71*	-0.53*	0.71*	0.72*	-0.53*	0.71*
Italy	0.64*	-0.34*	0.71*	0.56*	-0.31*	0.37*	0.70*	-0.34*	0.46*
Japan	0.65*	-0.50*	0.64*	0.75*	-0.36*	0.75*	0.63*	-0.38*	0.66*
Netherlands	0.59*	-0.38*	0.57*	0.56*	-0.36*	0.50*	0.57*	-0.34*	0.50*
Norway	0.13	-0.43*	0.11	0.84*	-0.44*	0.12	0.13	-0.42*	0.14
New Zealand	0.41*	-0.49*	0.45*	0.04	-0.54*	0.13	0.18*	-0.36*	0.04
Sweden	-0.0	-0.59*	0.11	0.08	-0.52*	0.11	0.11	-0.59*	0.01
US	0.84*	-0.30*	0.86*	0.83*	-0.29*	0.79*	0.85*	-0.29*	0.86*
<i>B. 1983-2005 Estimation Period</i>									
Australia	0.41*	-0.48*	0.53*	0.47*	-0.48*	0.47*	0.53*	-0.43*	0.57*
Canada	0.35*	-0.26*	0.34*	0.31*	-0.30*	0.33*	0.34*	-0.31*	0.35*
Finland	0.28*	-0.46*	0.33*	0.22*	-0.49*	0.27*	0.33*	-0.47*	0.30*
France	0.49*	-0.44*	0.67*	0.32*	-0.45*	0.52*	0.64*	-0.48*	0.70*
UK	0.20*	-0.58*	0.13	0.14	-0.53*	0.18	0.08	-0.57*	0.14
Ireland	0.08	-0.53*	0.08	0.08	-0.54*	0.08	0.19	-0.55*	0.15
Italy	0.33*	-0.36*	0.55*	0.35*	-0.37*	0.50*	0.52*	-0.36*	0.65*
Japan	0.24*	-0.62*	0.26*	-0.08	-0.59*	0.13	-0.01	-0.61*	0.05
Netherlands	0.01	-0.45*	-0.08	0.04	-0.49*	0.02	-0.08	-0.47*	-0.09
Norway	0.06	-0.45*	0.06	0.06	-0.46*	0.06	0.05	-0.42*	0.06
New Zealand	0.40*	-0.56*	0.42*	0.04	-0.54*	0.13	0.41*	-0.56*	0.40*
Sweden	-0.0	-0.59*	0.06	0.01	-0.52*	0.06	0.06	-0.58*	-0.03
US	0.47*	-0.40*	0.39*	0.33*	-0.45*	0.40*	0.43*	-0.45*	0.44*

Notes: First order autocorrelations of the residuals series from the estimated versions of the three structural models (SP, SI, and SPI) are given for the 13 countries in the dataset. Entries with superscript \* denote autocorrelation estimates that are significantly different from zero at a 10% significance level.



**Table 6: Inflation Autocorrelations Based on the Three Theoretical Models**

<i>A. Full Sample Estimation Period</i>											
<i>Measure of Inflationary Pressure</i>											
	<i>Output Gap</i>				<i>Labor Share</i>				<i>Unemployment</i>		
	<i>h</i>	<i>SP</i>	<i>SPI</i>	<i>SI</i>	<i>SP</i>	<i>SPI</i>	<i>SI</i>	<i>SP</i>	<i>SPI</i>	<i>SI</i>	
Australia	0.60*	0.05	0.98*	0.00	0.01	0.89*	0.25*	0.02	0.97*	0.11	
Canada	0.68*	0.03	0.94*	0.00	0.04	0.94*	0.15*	0.02	0.95*	0.00	
Finland	0.69*	0.05	0.97*	0.00	0.01	0.92*	0.06	0.10	0.95*	0.32*	
France	0.88*	0.20*	0.98*	0.00	0.01	0.94*	0.18*	0.12	0.97*	0.30*	
UK	0.66*	0.09	0.93*	0.00	0.01	0.88*	0.23*	0.00	0.95*	0.11	
Ireland	0.72*	0.00	0.88*	0.01	0.01	0.97*	0.01	0.09	0.95*	0.09	
Italy	0.75*	0.24*	0.96*	0.05	0.18*	0.95*	0.67*	0.06	0.98*	0.38*	
Japan	0.79*	0.00	0.97*	0.00	0.03	0.89*	0.06	0.45*	0.99*	0.41*	
Netherlands	0.66*	0.00	0.97*	0.03	0.03	0.90*	0.24*	0.11	0.96*	0.17*	
Norway	0.14	0.00	0.96*	0.04	0.04	0.99*	0.08	0.01	0.96*	0.00	
New Zealand	0.23*	0.02	0.99*	0.00	0.02	0.87*	0.00	0.03	0.99*	0.13	
Sweden	0.11	0.13	0.90*	0.00	0.02	0.76*	0.00	0.00	0.89*	0.15	
US	0.87*	0.04	0.94*	0.02	0.04	0.95*	0.27*	0.02	0.93*	0.01	
<i>B. 1983-2005 Estimation Period</i>											
Australia	0.57*	0.24*	0.97*	0.04	0.04	0.96*	0.15	0.06	0.95*	0.00	
Canada	0.36*	0.00	0.93*	0.02	0.05	0.96*	0.01	0.01	0.98*	0.00	
Finland	0.33*	0.04	0.93*	0.00	0.11	0.93*	0.06	0.00	0.90*	0.03	
France	0.71*	0.37*	0.95*	0.12	0.57*	0.97*	0.29*	0.19	0.97*	0.05	
UK	0.20	0.00	0.93*	0.04	0.01	0.86*	0.00	0.10	0.96*	0.04	
Ireland	0.08	0.00	0.86*	0.00	0.00	0.94*	0.00	0.49*	0.96*	0.50*	
Italy	0.62*	0.41*	0.97*	0.18	0.23*	0.96*	0.15	0.23*	0.93*	0.00	
Japan	0.36*	0.04	0.94*	0.10	0.33*	0.87*	0.19	0.03	0.93*	0.16	
Netherlands	0.04	0.01	0.87*	0.20	0.01	0.97*	0.04	0.04	0.93*	0.03	
Norway	0.06	0.00	0.97*	0.00	0.00	0.99*	0.00	0.00	0.93*	0.00	
New Zealand	0.42*	0.01	0.97*	0.00	0.02	0.87*	3.65	0.02	0.98*	0.04	
Sweden	0.06	0.11	0.88*	0.00	0.04	0.74*	0.00	0.00	0.88*	0.19	
US	0.52*	0.02	0.89*	0.18	0.20*	0.96*	0.12	0.03	0.97*	0.02	

Notes: See notes to Table 5. First order inflation autocorrelations from the estimated versions of the three structural models (SP, SI, and SPI) are given for the 13 countries in the dataset. The column denote “H” contains historical autocorrelations that are calculated only for estimation sample periods described in Section 3 above (and hence the historical autocorrelations above differ from those in Table 1.

**Table 7: Measures of Fit – Theoretical Models**

<i>A. Ratio of Fitted to Historical Inflation Standard Deviations: Full Sample Estimation Period</i>									
	<i>Measure of Inflationary Pressure</i>								
	<i>Output Gap</i>			<i>Labor Share</i>			<i>Unemployment</i>		
	SP	SPI	SI	SP	SPI	SI	SP	SPI	SI
Australia	0.2388	0.9693	0.0226	0.1149	0.8694	0.5373	0.1882	1.0164	0.4409
Canada	0.1835	0.9459	0.0709	0.2061	0.9275	0.3614	0.1519	0.9590	0.1254
Finland	0.2558	1.0207	0.0255	0.2170	0.9067	0.2476	0.2942	0.9326	0.5581
France	0.4533	0.9818	0.0496	0.1702	0.9320	0.4674	0.5650	1.0135	0.7774
UK	0.2702	0.9162	0.0532	0.1001	0.8559	0.5616	0.0894	0.9871	0.3839
Ireland	0.0584	0.9333	0.1698	0.0431	0.9521	0.0354	0.1332	0.9841	0.1729
Italy	0.4676	0.9566	0.3222	0.4033	0.9267	0.7559	0.3260	1.0110	0.7245
Japan	0.0401	0.9755	0.0718	0.3380	0.9582	0.3636	0.6302	0.9715	0.5832
Netherlands	0.0074	0.9777	0.1839	0.1719	0.8791	0.4737	0.4703	1.0204	0.5527
Norway	0.0766	0.9761	0.2007	2.6972	0.9936	0.1488	0.1056	0.9517	0.0038
New Zealand	0.1942	0.9566	0.0001	0.1664	0.8598	0.0047	0.2141	0.9194	0.4145
Sweden	0.3361	0.9715	0.0016	0.1587	0.7905	0.0000	0.0628	0.8714	0.2939
US	0.2110	0.9314	0.2161	0.2019	0.9515	0.5835	0.1555	0.9208	0.2150
<i>B. Ratio of Fitted to Historical Inflation Standard Deviations: 1983-2005 Estimation Period</i>									
Australia	0.5157	0.9722	0.2776	0.2336	0.9521	0.4487	0.2786	0.9419	0.0013
Canada	0.0070	0.8985	0.1691	0.1686	0.9541	0.1005	0.1334	0.9908	0.0015
Finland	0.2480	0.9445	0.0152	0.3172	0.9022	0.2710	0.0759	0.8971	0.1543
France	0.6553	1.1033	0.3991	0.7989	1.1273	0.6096	0.4254	1.0843	0.1751
UK	0.0374	0.9800	0.2775	0.1189	0.8743	0.0751	0.3216	0.9437	0.2357
Ireland	0.0007	0.9222	0.0350	0.0148	0.9801	0.0400	0.3682	0.9890	0.3512
Italy	0.6802	1.1093	0.4867	0.6719	0.9749	0.5724	0.4677	1.0353	0.0045
Japan	0.1987	0.9249	0.3176	0.5715	1.0183	0.4967	0.3490	0.8598	0.4976
Netherlands	0.0716	0.8741	0.3083	0.0874	0.9990	0.1555	0.3279	0.9081	0.3328
Norway	0.0062	0.9943	0.0116	0.0287	1.0195	0.0002	0.0665	0.9466	0.0013
New Zealand	0.1377	0.9967	0.0129	0.1664	0.8598	0.0047	0.1486	1.0099	0.1577
Sweden	0.3133	0.9588	0.0024	0.2080	0.8035	0.0015	0.0908	0.8682	0.2955
US	0.1257	0.8912	0.4352	0.4677	0.9601	0.4009	0.3644	0.9613	0.2986
<i>C. In-sample RMSE: Full Sample Estimation Period</i>									
Australia	5.0341	<b>4.3975</b>	5.1773	4.7342	4.3560	<b>4.1521</b>	4.9684	<b>4.4495</b>	4.5477
Canada	3.8158	<b>2.7265</b>	3.8943	3.5424	<b>2.9833</b>	3.5685	3.8212	<b>2.9748</b>	3.8353
Finland	<b>4.2090</b>	4.3713	4.3394	5.2651	<b>4.2176</b>	5.4071	5.2206	<b>4.2572</b>	4.5462
France	3.7697	<b>1.8625</b>	4.2534	3.8133	<b>1.9438</b>	3.5610	3.5504	<b>1.9422</b>	2.6282
UK	6.2124	<b>5.2333</b>	6.6264	6.0934	<b>5.2139</b>	5.2439	6.5370	<b>5.2437</b>	6.0550
Ireland	5.2537	<b>4.2376</b>	5.1941	5.8065	4.1855	5.8608	5.9606	<b>4.1211</b>	5.8915
Italy	6.2019	<b>5.0598</b>	6.7637	5.3325	5.0891	<b>4.4879</b>	6.6581	5.0947	<b>4.8374</b>
Japan	2.9439	<b>2.4030</b>	2.9391	4.6380	<b>2.9667</b>	4.5678	3.7444	<b>3.0575</b>	3.9273
Netherlands	3.4160	<b>3.0188</b>	3.3595	3.1545	<b>2.8769</b>	2.9657	2.9660	<b>2.6617</b>	2.7607
Norway	8.1860	10.4646	<b>8.0348</b>	24.9131	10.6877	<b>8.1089</b>	<b>8.1397</b>	10.6058	8.2036
New Zealand	<b>6.5208</b>	6.7811	6.7107	<b>4.6675</b>	6.0595	4.9361	10.1319	12.7993	<b>9.3456</b>
Sweden	<b>4.6377</b>	6.5191	5.0622	<b>4.9952</b>	6.3964	5.0629	5.0347	6.4872	<b>4.7968</b>
US	2.2957	<b>1.2381</b>	2.4587	2.1827	<b>1.2300</b>	2.0157	2.3568	<b>1.2149</b>	2.4702
<i>D. In-sample RMSE: 1983-2005 Estimation Period</i>									
Australia	<b>2.5931</b>	2.7924	2.8908	2.7036	2.7912	<b>2.6856</b>	2.8762	<b>2.7226</b>	3.0254
Canada	2.3963	2.6526	<b>2.3510</b>	<b>2.3309</b>	2.7039	2.3818	<b>2.3692</b>	2.7185	2.3962
Finland	<b>3.5788</b>	4.1470	3.6674	<b>3.4047</b>	4.1516	3.5086	3.6707	4.1231	<b>3.5942</b>
France	1.3385	<b>1.3050</b>	1.7314	1.1447	<b>1.3105</b>	1.4794	1.6758	<b>1.3125</b>	1.8720
UK	2.8454	3.5130	<b>2.7184</b>	<b>2.7399</b>	3.4890	2.8244	<b>2.6669</b>	3.5501	2.7558
Ireland	3.5411	4.6152	<b>3.5394</b>	3.5448	4.7906	<b>3.5421</b>	3.7794	4.7776	<b>3.6907</b>
Italy	<b>2.2492</b>	2.6827	2.8089	<b>2.2718</b>	2.7007	2.6654	2.6811	<b>2.6225</b>	3.2633
Japan	<b>1.9042</b>	2.3045	1.9366	<b>1.6385</b>	2.2163	1.7882	<b>1.6528</b>	2.2951	1.7169
Netherlands	2.3149	3.1450	<b>2.2029</b>	2.3430	3.2233	<b>2.3170</b>	2.2064	3.1933	<b>2.2018</b>
Norway	8.0143	10.8236	<b>8.0046</b>	8.0293	11.0262	8.0150	<b>7.9744</b>	10.8157	8.0133
New Zealand	<b>6.0146</b>	6.4588	6.0640	<b>4.6675</b>	6.0595	4.9361	5.9961	6.5056	<b>5.9853</b>
Sweden	<b>4.5657</b>	6.5578	4.9565	<b>4.8433</b>	6.4378	4.9580	4.9044	6.5306	<b>4.6892</b>
US	0.9680	0.9682	<b>0.9069</b>	<b>0.8463</b>	0.9864	0.9225	<b>0.9490</b>	0.9830	0.9665

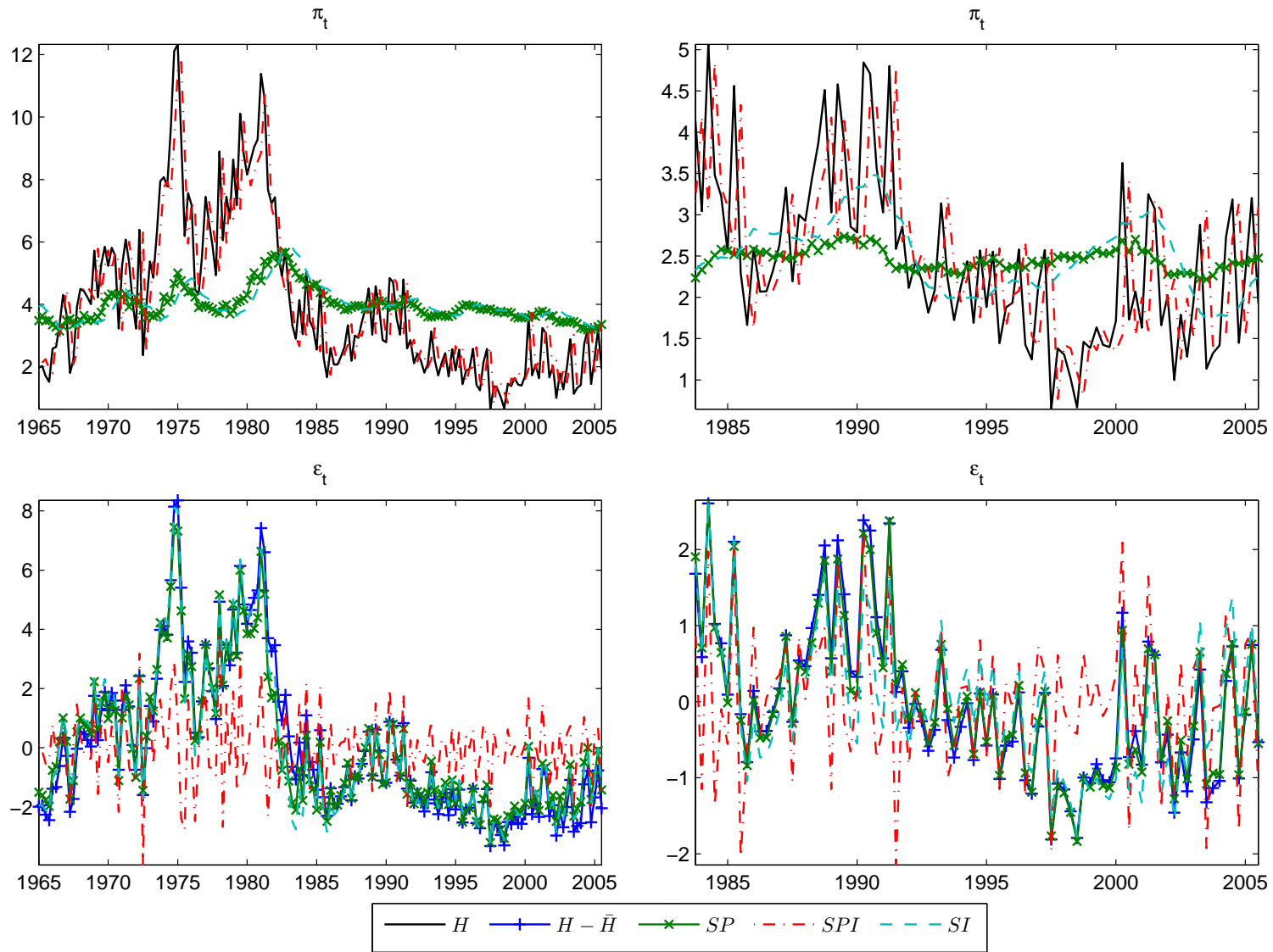
Notes: See notes to Table 6. Panels A and B report the ratio of fitted and historical inflation standard deviations. Panels C and D report in-sample root mean squared error. Bold font entries denote models with minimum RMSE, for a given measure.

**Table 8: CS Distributional Accuracy Tests Based on the Joint Distribution of  $\pi_t$  and  $\pi_{t-1}$**

<i>A. Full Sample Estimation Period</i>									
<i>Measure of Inflationary Pressure</i>									
	<i>Output Gap</i>			<i>Labor Share</i>			<i>Unemployment</i>		
	SP	SPI	SI	SP	SPI	SI	SP	SPI	SI
Australia	2.9055	<b>2.7551</b>	2.9301	2.9720	<b>2.7153</b>	2.8619	2.9801	<b>2.8696</b>	2.9854
Canada	3.0669	<b>2.8525</b>	3.0572	3.2197	<b>3.0347</b>	3.1767	3.1710	<b>3.0602</b>	3.2084
Finland	2.6509	<b>2.4747</b>	2.6461	2.8556	<b>2.6274</b>	2.8177	<b>2.7841</b>	2.8163	2.7912
France	3.2490	<b>2.7972</b>	3.3662	3.3601*	<b>2.8391</b>	3.0603	3.2624	<b>2.8155</b>	3.4129
UK	2.9471	<b>2.6808</b>	2.9790	2.9798	<b>2.6629</b>	2.8135	2.9834	<b>2.7302</b>	2.9850
Ireland	2.6373	<b>2.3683</b>	2.6201	2.7841	<b>2.5660</b>	3.0481	3.0567	<b>2.5499</b>	3.1064
Italy	3.0273	<b>2.7320</b>	3.1608	3.1965	<b>2.7369</b>	3.0044	3.1595	<b>2.7816</b>	3.0498
Japan	2.6108	<b>2.4710</b>	2.6485	3.0306	<b>2.6794</b>	3.0160	2.7605	3.0098	<b>2.6798</b>
Netherlands	2.6368	<b>2.5374</b>	2.6060	2.8287	<b>2.6835</b>	2.7699	3.1294	3.1015	<b>3.0515</b>
Norway	1.6929	2.1561	<b>1.6929</b>	1.8324	2.3408	<b>1.6931</b>	<b>1.6914</b>	2.0662	1.6917
New Zealand	2.4149	<b>2.3651</b>	2.4214	<b>1.7332</b>	1.7941	1.7432	2.6883	4.9482	<b>2.6368</b>
Sweden	<b>2.0618</b>	2.1549	2.0673	<b>2.0666</b>	2.0777	2.1039	2.0601	2.2125	<b>2.0517</b>
US	3.5251	<b>3.0247</b>	3.5459	3.6636*	<b>3.1435</b>	3.5375	3.6865*	<b>3.1016</b>	3.7148
<i>B. 1983-2005 Estimation Period</i>									
Australia	2.2356	2.2238	<b>2.1706</b>	2.1483	2.1384	<b>2.1263</b>	2.2460	<b>2.0825</b>	2.1978
Canada	<b>1.8465</b>	1.9632	1.8479	<b>1.8614</b>	2.0746	1.8902	1.8598	2.2817	<b>1.8531</b>
Finland	2.2384	<b>2.2219</b>	2.2749	2.2565	<b>2.1536</b>	2.2387	2.2956	<b>2.1360</b>	2.2853
France	2.4159	<b>2.3439</b>	2.6477	<b>2.3155</b>	2.3957	2.5721	2.5838	<b>2.2043</b>	2.6600
UK	1.8624	2.0667	<b>1.8610</b>	1.8675	1.9793	<b>1.8594</b>	<b>1.8597</b>	2.2085	1.8788
Ireland	2.0994	<b>2.0864</b>	2.0894	<b>2.0810</b>	2.1924	2.1084	<b>2.0448</b>	2.1441	2.3406
Italy	2.3272	<b>2.2356</b>	2.3768	2.4030	<b>2.2056</b>	2.4257	2.4979	<b>2.2300</b>	2.5073
Japan	2.1253	<b>2.0939</b>	2.1766	2.0782	2.1404	<b>2.0716</b>	2.1133	2.1107	<b>2.0854</b>
Netherlands	<b>1.5853</b>	1.8526	1.6238	<b>1.5963</b>	2.1488	1.5994	1.6103	2.0523	<b>1.5909</b>
Norway	<b>1.5197</b>	1.8154	1.5273	1.5263	2.0416	<b>1.5251</b>	<b>1.5237</b>	1.6973	1.5275
New Zealand	2.1749	<b>2.1557</b>	2.1691	<b>1.7234</b>	1.7903	1.7452	2.1924	2.3487	<b>2.1707</b>
Sweden	<b>1.9306</b>	2.0493	1.9682	<b>1.9841</b>	2.0119	2.0123	<b>1.9752</b>	2.0714	1.9927
US	2.1236	<b>2.0475</b>	2.1077	<b>2.0418</b>	2.0765	2.1467	<b>2.1059</b>	2.3233	2.1241

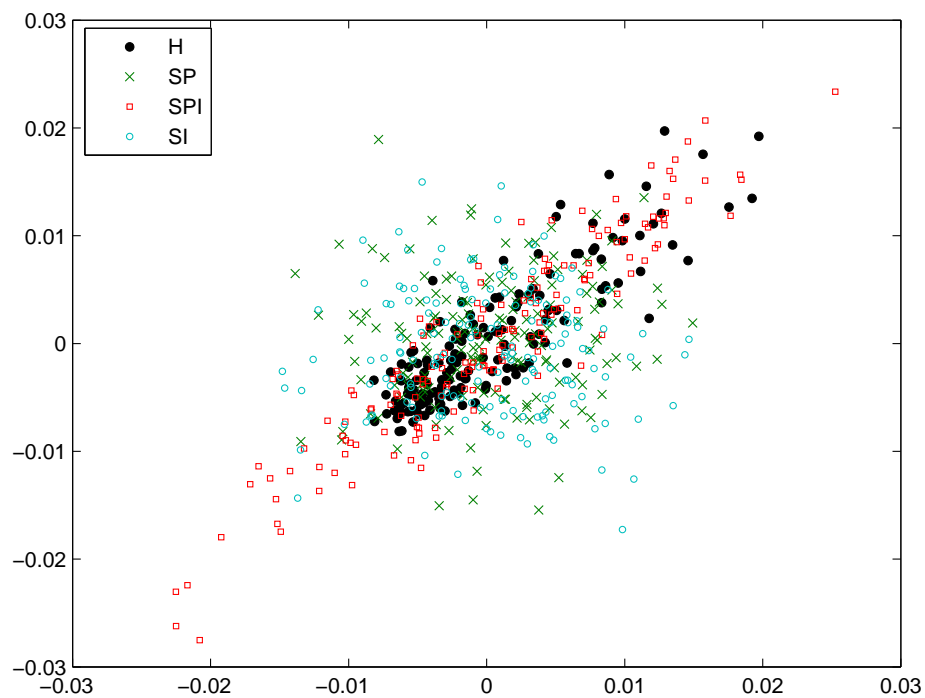
Notes: Entries in the table are Corradi and Swanson (CS: 2006b) distributional loss statistics associated with the three structural models, and are estimates of:  $E \left( F_i(u; \theta_i^\dagger) - F_0(u; \theta_0) \right)^2$ . In particular, entries are of  $CS = \int_U \frac{1}{T} \sum_{t=1}^T \left( 1\{Y_t \leq u\} - \frac{1}{S} \sum_{n=1}^S 1\{Y_{i,n}(\hat{\theta}_{1,T}) \leq u\} \right)^2 \phi(u) du$  (see above for complete details). Bold font entries denote models with a minimum CS distribution loss, for a given inflation pressure measure. We test whether the alternative models have significantly lower CS loss than the benchmark SP model. The test is based on bootstrap critical values constructed using 100 bootstrap replications. Entries with superscript \* indicate models for which the CS loss measure is significantly higher for the benchmark model using 10% significance level critical values. All statistics are based on a grid of 20x20 values of  $u$ , where  $u$  is distributed uniformly between the 25% and 75% quantiles of the historical range of inflation. Further details are given above.

Figure 1: In-sample Fit and Residuals for Structural Models Estimated Using U.S. Data and the Output Gap  
*Full Sample* *Sample 1983-2005*



Notes:  $H$  denotes historical inflation;  $H - \bar{H}$  denotes historical inflation without sample average; and  $SP$ ,  $SPI$ , and  $SI$  are the structural models discussed above. For expository purposes, we add the mean back to the fitted values, and we convert quarterly changes into yearly. Fitted and actual values are plotted in the upper two graphs, while residuals are plotted in the lower two graphs.

Figure 2: Scatter Plot of Simulated  $\pi_t$  and  $\pi_{t-1}$  Observations for the Structural Models



Notes: See notes to Figure 1. The simulated sample size is  $50T$ , where  $T$  denotes the number of observations used to estimate the model. In the graph, every 50th value of the simulated samples are plotted, in order to make the graph visually coherent.