Discussion of

Price and Consumption Responses to Large Exchange Rate Shocks: Evidence from the 2015 Appreciation in Switzerland

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Introduction

• Recent period of turbulence in world economy gave rise to great “natural experiments” for IFM research. In particular:
  — A large appreciation of the US dollar in 2008
  — A large devaluation episode in Japan in 2012
  — A large appreciation in Switzerland in 2015

• This paper uses impressively detailed data on prices and expenditure of Swiss households to document the full anatomy of the 2015 appreciation

• Unique features of the data:
  1. Consumer price data of imported goods
  2. Unit price data in Switzerland and in neighboring countries
  3. Consumption expenditure data on purchases from abroad
Key insights

1. Fairly rapid and complete drop in prices at the border contrasts with a slow and small pass-through into the consumer price index, even in light of Swiss openness.

2. Consumer prices of imported goods (in particular from EZ) decline relatively fast with a 40% ERPT after 12 months.

3. Sharp increase in the incidence of price decreases, with a decrease in absolute average size of price declines (menu cost).

4. Noticeable sensitivity of Swiss domestic product prices to price declines of foreign competitors (strategic complementarities?)

5. Sizeable time-series demand elasticities and expenditure switching towards imports (with heterogeneity).
Import vs Consumer Prices

Figure 3: CHF/EUR and official consumer and import price indices

- Aggregate price indexes show rapid and nearly complete ERPT into border prices and virtually no pass-through into consumer prices
- Remarkably little pass-through into consumer prices given the degree of trade openness of Switzerland (is it a puzzle?)
Import vs Consumer Prices

Figure 2: CHF/EUR and homescan price indices

- Micro price data: rapid and sizeable (∼40%) ERPT into consumer prices of import goods (limited role of the distribution margin?)
- Nearly flexible price adjustment? Ok to ignore price stickiness?
Mechanics of Price Adjustment

Figure 4: Frequency of price changes

- Two months with almost 35% probability of price adjustment (all increment due to extra price decreases)
- Indeed, akin to a flexible-price (menu cost) response to this large aggregate shock. Implications for a large border tax reform!
(b) Decreases

- Surprising? In light of the very high incidence of adjustment?
- Unusually high incidence and size of price adjustments
Comparison with the US 2008
Gopinath, Itskhoki and Neiman (2012)

Figure: US trade price indexes

- About as large an appreciation episode (but different circumstances: global trade collapse)
- Virtually no decline in border prices for differentiated goods!
Comparison with the US 2008
Gopinath, Itskhoki and Neiman (2012)

Figure: Frequency and Absolute Size of Price Adjustments

- Similar mechanics of adjustment, but much more muted
- Very different base magnitudes for incidence and size of adjustment
- Is US special or is Swiss data very selected by type of products?
Strategic Complementarities?

- Significant comovement between home and foreign product prices within categories
- Suggestive of strategic complementarities, but difficult to exclude common cost shocks (common foreign intermediate inputs)
- Still most domestic price changes centered around zero (intercept!)
• An apparent upward trend in the import expenditure share. A more sophisticated identification strategy is needed.
Heterogeneity

- Heterogeneous response of expenditure
  - across products
  - across households by income groups (non-homotheticities?)
  - across geographical locations

- Clear evidence: trade elasticity is not a universal primitive. Decomposition of the aggregate trade elasticity to shed light on the “elasticity puzzle” under counterfactual scenarios

- Border and distance effects
  - “No arbitrage” is clearly violated (even prior to appreciation!)
  - Yet, some households take advantage of the arbitrage opportunities
  - This calls for a model of optimal price setting under heterogenous consumer arbitrage (discrete choice?)