Dynamic Inertial Price Index and regional resilience in the EU in the aftermath of the global Financial Crisis: the Italian case

Extended abstract

The evolution of prices have always been at the centre of the economic debate as the corner stone of macroeconomic dynamics and microeconomics of consumption as well as the key junction of monetary and fiscal policies. After the Global Financial Crisis (GFC) they have gained even more momentum in the debate about public debt sustainability, resilience and the effectiveness of policy measures among which austerity was particularly disputed.

The standard measure of price evolution is Consumer Price Index and it is used to set up monetary policy measures, to index salaries and pensions and to frame the vast majority of academic literature regarding prices. CPI, though, is itself one of the many feasible measures of price dynamics among the index numbers universe. It is controversial, it has some technical and theoretical shortcomings and regarding its economic purposes certainly it is not widely accepted as the best way of addressing the change in prices and their economic effects.

The long tradition of theoretical and empirical contributions to measure price changes and their effects provided manifold approaches encompassing either non-economic (e.g. (i) tabular or fixed basket, (ii) (pure) statistic and (iii) test (or axiomatic)) or mostly economic methodologies (e.g. (i) bound (or non-parametric), (ii) exact and (iii) econometric). The index itself has been regarded has an eminent statistical issue (Cost-of-goods) or a mostly economic one (Cost-of-living) providing a flourishing list of different measures with different characteristics and ideal usage.

The cutting edge of this academic debate is about the provision of a dynamic price index: an index deeply rooted in the (micro)economic theory of consumption in which agents' intertemporal choice and the effects of price change on their consumption pattern is the prime concern (Reis 2005). Inflation in such a framework is not just a weighted average of price change in a sample consumption bundle, it is the result of the combination between change in prices and consumption rebalancing where the agents are forward looking and can tune their choices with the new framework.

Building on this dynamic framework an enhancement has been proposed in order to make it more realistic. As the most recent theoretical contributions are suggesting consumers' choice is not just a dynamic forward looking optimization problem, but through habit formation it has a strong backward looking component which cannot be neglected. A Dynamic Inertial Price Index (DIPI) has

been, then, modelled and tested on real data to prove its characteristics and aptitude to be produced on a regular basis.

Given the claimed ineffectiveness of CPI in representing correctly inflation as an statistical and economical issue (See the Stigler Commission 1961 and Boskin Commission 1996) and building on this new index this paper aims to test the reliability and effectiveness of an alternative measure of inflation compared with the standard one. The sample used for the test is not irrelevant itself though. Given its crucial role for theoretical as well as policy issue I choose to test the new measure on Italian data and that is the second main novelty of the paper. The Eurozone has had a long lasting debate about austerity measures, its effectiveness in tackling the aftermath of the GFC and its compatibility with a monetary policy dealing with an extreme heterogeneous economic framework and often missing its own target. Within the Eurozone Italy is a country of major concern with respect to both monetary and fiscal policy. It has the second largest public debt in the Eurozone (source Eurostat 2014) and it is trying to cope with a secular idiosyncratic heterogeneity (North-South dichotomy) increasing even more the complexity of the economic framework. That is an excellent field to: test a new policy tool against standard measures and focus on the resilience to major shocks such as the GFC in an extremely heterogeneous framework.

Building on the already proved procedure used to test the DIPI on USA data, the paper is able to address the Italian issue making it a case of support for the adoption of improved methodologies to frame policy measure. It is also able to sketch feasible future dynamics at a micro and macro level finally addressing the resilience of highly heterogeneous economic frameworks.