

The eighth edition of the Salento Macro Meetings took place in Lecce, Italy, on 1 and 2 July 2025. The objective of this event was to bring together distinguished researchers in Macroeconomics in the relaxed and fruitful atmosphere of Salento, the peninsula located in the southernmost region of Apulia, Italy. Find a summary of the event in this newsletter.

This newsletter also features **four presentations from the PSE Macro Days 2025**. Sessions at the event covered monetary and fiscal policy, including how labour demand and tax structures interact with monetary policy frameworks; the dynamic effects of tariff shocks and how production networks propagate those shocks; and the role of housing and monetary transmission channels in modern economies. [+](#)



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CHAIR

SCOR



PARIS SCHOOL OF ECONOMICS
ÉCOLE D'ÉCONOMIE DE PARIS

Macroeconomic Risk

Summary: Salento Macro Meetings 2025

The Macroeconomic Risk Chair co-organized the 2025 edition of the Salento Macro Meetings. [+](#)

[The Salento Macro Meetings 2025](#), held on July 1st and 2nd at the Hotel Risorgimento in Lecce, Italy, brought together leading macroeconomists for two days of academic exchange in a relaxed, culturally rich setting. Organized by Gaetano Gaballo (HEC Paris, CEPR) and Francesco Pappadà (Ca' Foscari & PSE), with financial support from CEPREMAP, the SCOR Macroeconomic Risk Chair, and the European Research Council, the event focused on contemporary issues in macroeconomic theory and policy. Topics included monetary policy in open and closed economies, macro-financial risk, inflation, expectations, and firm dynamics.

The workshop featured presentations from invited keynotes such as Dimitri Vayanos (LSE, CEPR), who spoke about New Keynesian models in the context of bond and currency markets; Javier Bianchi (Federal Reserve Bank of Minneapolis), who explored optimal monetary policy responses to tariffs; and Mirko Wiederholt (LMU Munich, CEPR), who presented research on the role of macroeconomic narratives.

The 2025 edition invited theoretical and empirical contributions on the above themes, with a special effort to encourage submissions from underrepresented groups. The call for papers received more than 180 high-quality submissions coming from researchers both in Academia and in Central Banks, mostly from Europe and the United States. The scientific committee selected seven papers, and invited a discussant for each speaker.

The full list of participants included: Javier Bianchi (Federal Reserve Bank of Minneapolis), Diego Bohorquez (Banca d'Italia), Nina Boyarchenko (FED New York, CEPR and Cesifo), Husnu Dalgic (University of Mannheim), Keshav Dogra (FED New York), Leonardo Elias (FED New York), Charles Engel (University of Wisconsin, NBER and CEPR), Joel Flynn (Yale University), Gaetano Gaballo (HEC Paris, CEPR), Mishel Ghassibe (CREI), Sylvérie Herbert (Banque de France), Marek Ignaszak (Goethe University Frankfurt), Peter Karadi (European Central Bank, CEPR), Aicha Kharazi (University Of Exeter), Francesco Pappadà (Ca' Foscari,

PSE), Dimitris Vayanos (LSE, CEPR), Mirko Wiederholt (LMU Munich, CEPR) and Jasmine Xiao (University of Notre Dame).

Across the two days, sessions delved into a wide range of pressing topics. These included firm expectations and innovation-driven growth, economic trade-offs between income groups, the influence of measured beliefs on monetary non-neutrality, and the structure of corporate debt over global credit cycles. The papers presented at the Salento Macro Meetings 2025 also touched upon information diffusion, central bank communication strategies, asset purchases, and the role of heterogeneous beliefs in shaping market responses.

Overall, the Salento Macro Meetings 2025 provided an engaging and intimate platform for high-level discussions on macroeconomic policy and research, combining rigorous academic content with the scenic and historical charm of southern Italy.



TUESDAY JULY 1ST

- 9:30 **Welcome**
Gaetano Gaballo (HEC Paris, CEPR), Francesco Pappadà (Ca' Foscari, PSE)
- 09:45-10:30 **Invited talk**
A New Keynesian Open Economy Model with Frictional Bond and Currency Markets
Dimitri Vayanos (London School of Economics)
- 10:30-11:15 **Firm Expectations, Innovation and Growth**
Georg Duernecker, Marek Ignaszak (Goethe University Frankfurt), Jisu Jeun, Leo Kaas
Discussant: Francesco Pappadà (Ca' Foscari, PSE)
- 11:15-11:30 **Coffee break**
- 11:30-12:15 **Tradeoffs for the poor, divine coincidence for the rich**
Marco Del Negro, Ibrahima Diagne, Keshav Dogra (FED New York), Pranay Gundam, Donggyu Lee, Brian Pacula
Discussant: Aicha Kharazi (University Of Exeter)
- 12:15-13:00 **What Can Measured Beliefs Tell Us About Monetary Non-Neutrality?**
Hassan Afrouzi, Joel P. Flynn (Yale University), Choongryul Yang
Discussant: Mishel Ghassibe (CREI)
- 13:00-14:00 **Lunch**
- 14:00-14:45 **Invited talk**
The Optimal Monetary Policy Response to Tariffs
Javier Bianchi (FED Minneapolis)
- 14:45-15:30 **Collateral Advantage: Exchange Rates, Capital Flows, and Global Cycles**
Michael B. Devereux, Charles Engel (University of Wisconsin, NBER and CEPR), Steve Pak Yeung Wu
Discussant: Diego Bohorquez (Banca d'Italia)
- 15:30-15:45 **Coffee break**
- 15:45-16:30 **Corporate Debt Structure over the Global Credit Cycle**
Nina Boyarchenko (FED New York, CEPR and Cesifo), Leonardo Elias
Discussant: Husnu Dalgic (University of Mannheim)
- 18:30 **Guided tour of Lecce**
- 20:00 **Social dinner**

WEDNESDAY JULY 2ND

- 09:30-10:15 **Invited talk**
Narratives about the Macroeconomy
Mirko Wiederholt (LMU Munich)
- 10:15-11:00 **Information Spreads**
Antonio Falato, Joseph Kaboski, Jasmine Xiao (University of Notre Dame)
Discussant: Leonardo Elias (FED New York)
- 11:00-11:15 **Coffee break**
- 11:15-12:00 **Disentangling Monetary Policy, Central Bank Information, and Fed**
Response to News Shocks
Marek Jarociński, Peter Karadi (European Central Bank, CEPR)
Discussant: Sylvérie Herbert (Banque de France)
- 12:00-12:45 **ERC presentation**
Asset Purchases and Heterogeneous Beliefs
Gaetano Gaballo (HEC Paris, CEPR), Carlo Galli
- 12:45-14:00 **Lunch**
- 15:30 **Bus departure to Porto Selvaggio (Ionian Sea)**

Organizers:
Gaetano Gaballo (HEC Paris, CEPR)
Francesco Pappadà (Ca' Foscari Venice, PSE)



The organizers kindly acknowledge the financial support from CEPREMAP, the SCOR Macroeconomic Risk Chair at PSE and the European Research Council (ERC).

Business Cycles with Pricing Cascades

Mishel Ghassibe (Barcelona School of Economics) and Anton Nakov (European Central Bank)

Business Cycles with Pricing Cascades, Working Paper, July 2025. [+](#)

Why do some economic shocks—especially large ones—trigger powerful waves of price changes and sudden inflation surges, even when overall economic activity remains relatively stable? Put simply: why do prices sometimes move slowly and quietly, and other times shift all at once? In their paper, Mishel Ghassibe and Anton Nakov explore how the structure of the economy and firms' pricing decisions interact to produce these rapid chains of price adjustments, which they call "**pricing cascades**."

At the heart of the paper is the idea that firms do not continuously adjust prices. Many wait until their costs move enough to justify the effort. However, because firms buy from each other across long production chains, a cost increase for one firm becomes a cost increase for others downstream. This sets off a chain reaction: one firm raises its prices, forcing others to do the same, and so on. The process ripples through the production network, triggering more and more price updates.

How large the cascade becomes depends on two factors: first, how sensitive firms' pricing is to cost changes (do they wait, or adjust quickly?); second, how interconnected sectors are (a shock in a key upstream sector spreads more widely). To capture these effects, the authors build a model of the economy in which many different sectors buy and sell from one another. In each sector, firms decide whether to adjust their prices based on whether the shock they face is "big

enough." The model follows the actual production structure of the euro area, reflecting real-world connections between sectors like energy, food, manufacturing, and services.

The authors then simulate economic shocks—both demand shocks (for example, a monetary expansion) and supply shocks (such as sharp drops in productivity or increases in input costs)—and study how price changes spread through the network.

When a positive demand shock hits the economy (for instance, interest rates fall or demand rises), firms face higher demand rather than higher costs. In this case, the **production network tends to soften the pricing cascade**.

Firms adjust prices, but the wave is not explosive. This allows the economy to expand more strongly because prices rise more gradually, giving monetary policy more traction.

The story is quite different for supply shocks. **When a shock raises firms' costs**—especially when it hits a central upstream sector like energy—the **cascade becomes much more forceful**. A large negative productivity or energy shock

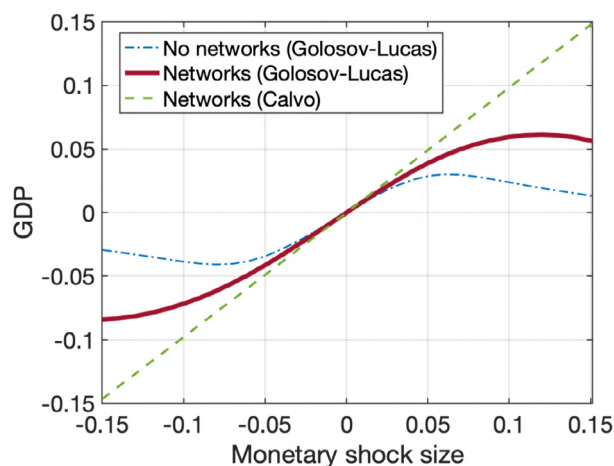
causes firms throughout the network to revise their prices almost at once, generating a broad inflation surge. In these situations, the pricing cascade amplifies inflation significantly more than the shock itself might suggest.

Sectors that sit early in the production chain have a disproportionately large influence because they supply many other sectors, allowing shocks to spread widely and quickly. Shocks to more peripheral sectors generate much smaller cascades. When the authors feed the model the kinds of shocks the euro area experienced during the post-pandemic inflation spike, the model reproduces both the sharp rise in the frequency of price changes and the strong surge in inflation. Without allowing for pricing cascades, such patterns are much harder to explain.

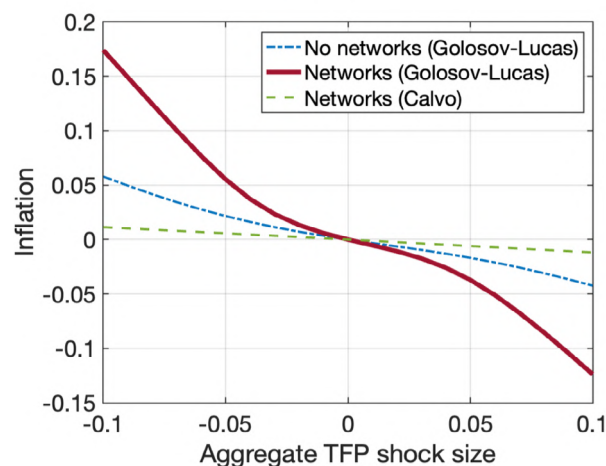
When a positive demand shock hits the economy, the production network tends to soften the pricing cascade.

In conclusion, Ghassibe and Nakov demonstrate that the inclusion of production networks has a substantial effect on pricing behavior throughout the economy. The centrality of a given sector, along with the type of shock it experiences, plays a crucial role in determining the aggregate response—an insight that holds particular relevance for policymakers.

(b) GDP



(b) CPI inflation



State and Time-Dependent Pricing

Philip Bunn (Bank of England), Nicholas Bloom (Stanford University), Craig Menzies (Bank of England), Paul Mizen (King's Business School), Gregory Thwaites (University of Nottingham), and Ivan Yotzov (Bank of England)

State and Time-Dependent Pricing, Working Paper, November 2025. [+](#)

One of the most important aspects of inflation phenomena is the price-setting behavior of companies. Yotzov and coauthors seek to understand how firms actually decide when to change their prices. Do they revisit prices at fixed intervals ("time-dependent")—for example, once a quarter—or do they change prices only when something important happens, such as a cost shock or a sudden shift in demand («state-dependent»)? The authors want to know which of these behaviors dominates among firms in the UK, how it has changed during the recent period of high inflation, and whether these two pricing styles lead to different reactions when firms are hit by cost shocks, such as rising oil or gas prices.

While most existing knowledge about pricing behavior comes from consumer price data, this paper provides something new: direct answers from thousands of firms on how they set prices. This allows Yotzov and coauthors to link firms' own descriptions of their behavior with how sensitive they are to economic shocks, particularly during the inflationary period following the Covid-19 disruptions and the energy price surge.

The study uses a large monthly survey of UK companies, where firms were asked how they typically decide on price changes and how often they actually changed prices over the past five years. The authors combine these responses with firm characteristics—such as sector, size, and cost structure—and with measures of external shocks, including increases in energy costs. They then study how different types of firms adjust their

prices after these shocks, comparing state-dependent and time-dependent firms.

A slight majority of firms report using **state-dependent pricing**. This tendency became even stronger during the peak inflation years, meaning that when the economy became more volatile, more firms said they were changing prices only when they "needed to," rather than following a calendar. Firms with more volatile costs—especially goods-producing sectors and firms heavily exposed to material prices—tend to be state-dependent. Service providers and large firms are more likely to follow fixed price-review schedules.

Price changes became more common as inflation rose, increasing noticeably during the energy price surge and then easing but remaining above pre-pandemic levels. This rise was driven mainly by state-dependent firms, which reacted quickly when their costs jumped. Time-dependent firms also increased their price changes, but more gradually, because their schedules limit how fast they can adjust.

A key result is that **state-dependent firms react more strongly and more quickly to rising energy costs**. When oil or gas prices spike, these firms pass through a larger share of the cost increase and do so sooner. Time-dependent firms react more

slowly and rarely change prices outside their regular review periods unless the shock is extremely large.

This difference in responsiveness means that in periods of large economic shocks, state-dependent firms play a bigger role in driving overall inflation, while time-dependent firms smooth out the inflation path.

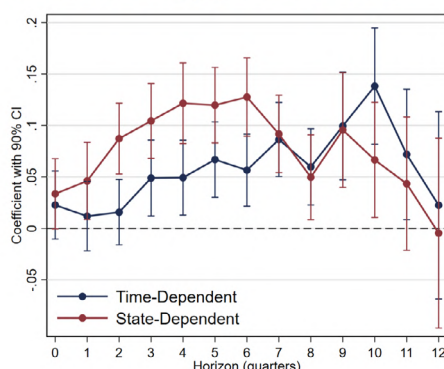
Most firms maintain their pricing style consistently. Once a firm is state-dependent or time-dependent, it rarely switches, even when conditions change. However, the small amount of switching that does occur tends to happen during high-inflation periods, with some firms temporarily becoming more state-dependent.

State-dependent firms react more strongly and more quickly to rising energy costs.

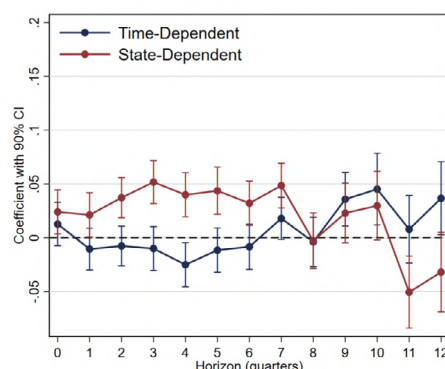
Yotzov and coauthors present us with a study of inflation dynamics from a less-investigated side—the supply side—by examining differences in the behavior of companies following two types of pricing

rules: time-dependent and state-dependent. **The analysis shows how these differences matter for the speed and size of price changes when the economy is hit by shocks**, providing new empirical evidence on which theoretical models best capture firm behavior during periods of economic volatility.

Panel A: Oil Supply News Shocks



Panel B: Gas Supply Shocks



The Unequal Costs of Pollution: Carbon Tax, Inequality, and Redistribution

Cristiano Cantore (Sapienza University of Rome), Giovanni Di Bartolomeo (Sapienza University of Rome), and Francesco Saverio Gaudio (Sapienza University of Rome)

The Unequal Costs of Pollution: Carbon Tax, Inequality, and Redistribution, Working Paper, February 2025. [+](#)

How should governments design carbon taxes when households differ in income and financial capacity? This paper by Cantore and coauthors examines **how inequality fundamentally reshapes optimal carbon tax policy**, addressing two central questions: How does inequality influence the level and behavior of a carbon tax? And how does a carbon tax affect different households?

The authors explore the interaction between environmental policy and inequality, showing that this interaction critically shapes government choices. At the heart of such problems lie two opposing forces: the environmental benefit of taxing emissions, which reduces pollution and raises overall welfare, and the distributional impact of the tax, which affects households differently depending on their income and ability to save.

Cantore and coauthors model two types of households: **savers**, who can smooth their consumption over time and hold assets, and **hand-to-mouth households**, who consume all their income immediately

and are therefore more vulnerable to economic fluctuations and policy changes. Both groups dislike pollution, but poorer households feel its negative effects more strongly relative to their income. At the same time, poorer households are also more sensitive to price changes caused by the tax. This creates a trade-off: the carbon tax helps them through cleaner air, but it also raises the prices of goods they consume.

Intuitively, the economy produces goods using energy, which generates emissions. Emissions accumulate in the atmosphere and reduce household well-being. The government can set an optimal emission tax rate. Cantore examines two scenarios: when the government can redistribute

income freely across household groups and when it can only redistribute using revenues from the carbon tax itself—a more realistic constraint. In both cases, the optimal tax reflects a balance between improving environmental quality and limiting the burden on households, but the balance differs sharply depending on whether redistribution is constrained.

When redistribution is unconstrained, the government can compensate poorer households for any costs created by the carbon tax. In this situation, the tax fully reflects the environmental damage created by emissions. Its level and behavior resemble what one would expect if all households were identical. Inequality does not influence the tax because the government can smooth out all distributional consequences.

When redistribution is constrained to carbon tax revenues, the picture changes dramatically.

When redistribution is constrained to carbon tax revenues, the picture changes dramatically.

Since the government cannot freely adjust transfers, the tax must now balance environmental goals with the burden placed on poorer households. Because poorer households

are more vulnerable, the government cannot push the tax as high as in the fully flexible case. However, because they also suffer more from pollution, the environmental motive still pushes the tax upward. These two forces pull in opposite directions, shaping a new «second-best» tax that reflects both ecological and social considerations.

The authors find that in normal times, the tax roughly follows environmental damages. But during economic fluctuations, especially recessions, the presence of poorer, financially constrained households matters greatly. When economic conditions worsen and inequality effectively rises, the government leans toward reducing the tax's burden

on those households. **This makes the tax more sensitive to business cycle conditions than in standard models.**

The carbon tax tends to benefit poorer households through improved environmental quality, but only if some revenues are used to support them. If the state cannot redistribute much, the tax may weigh more heavily on them, even though they care more about environmental improvements. The analysis therefore highlights the importance of well-designed recycling of carbon-tax revenues.

Cantore's paper shows that inequality changes how a carbon tax should be designed. The central message is that climate policy and inequality cannot be treated separately: effective and fair carbon taxation requires careful attention to differences across households and the government's ability—or inability—to mitigate them.



Putting the Finance Back in Public Finance

Stijn Van Nieuwerburgh (Columbia Business School)

Putting the Finance Back in Public Finance, PSE Macro Days keynote, September 2025. [+](#)

In his keynote address, Stijn Van Nieuwerburgh tackled one of the most pressing questions in macroeconomics: how much debt can a country safely take on? Focusing on the United States—where public debt has surged dramatically since the global financial crisis and the Covid-19 pandemic—Van Nieuwerburgh examined whether the U.S. still has the capacity to borrow without jeopardizing the safety of its government bonds. **The central question is whether current debt levels are sustainable and what economic forces determine the limits of fiscal policy.**

Van Nieuwerburgh's analysis begins with a simple but powerful idea: government debt behaves much like a financial asset. For debt to be valuable, it must be backed by future government surpluses, meaning taxes that exceed spending. The market value of outstanding debt should equal the discounted value of those future surpluses. However, future surpluses are inherently risky. Tax revenues decline in recessions, spending increases during downturns, and the economy faces substantial long-run uncertainty. Because of this risk, the claim on future surpluses that debt represents should carry a significant risk premium. When investors face risky cash flows, they normally demand higher returns.

This creates a **valuation puzzle**: U.S. government debt is priced as if it is extremely safe and commands very low interest rates—even though the underlying risks are substantial. When the market value of existing government debt is compared with what future surpluses realistically look like, adjusted for economic risk, a large gap appears. The value of debt far exceeds what future surpluses seem to justify. In other words, investors are willing to pay much more for U.S. government bonds than the country's long-term finances alone would predict. This gap averaged 360% of GDP and grew to 700% by 2020, particularly after periods with strong demand for safe assets such as the global financial crisis or the pandemic.

The central question is whether current debt levels are sustainable and what economic forces determine the limits of fiscal policy.

Van Nieuwerburgh presented several possible explanations. Government debt helps households and investors smooth risk across time, and people value this stability, especially during turbulence, leading them to accept lower returns. Investors may implicitly assume the government will eventually take corrective action—raising taxes or cutting spending—before debt becomes unsustainable, keeping bond prices high even if policy has not yet adjusted. Government debt also provides **convenience benefits** beyond financial return: safety, liquidity, and ease of trading. These benefits make investors willing to accept even lower yields, though they do not fully explain the large valuation gap.

Van Nieuwerburgh emphasized that governments can delay fiscal adjustment for a surprisingly long time, but not forever. When debt becomes sufficiently high, fiscal tightening must eventually begin. Research he presented with Elenev and Landvoigt suggests that the U.S. faces an austerity threshold—the point beyond which adjustment can no longer be delayed if debt is to remain default-free. This threshold depends on several factors, including risk aversion, labor supply elasticity, the share of households that are hand-to-mouth, debt maturity structure, and political uncertainty. Under certainty about which form of austerity will occur (tax increases or spending cuts), the threshold is around 195% of GDP for tax austerity and 183% for spending austerity. However, if there is uncertainty over which regime will prevail—reflecting changes in political control—the threshold drops dramatically to 110% of GDP.

The overall picture suggests that the U.S. enjoys an unusual degree of fiscal capacity—its bonds remain extremely valuable despite large and rising debt. However, this capacity is not unlimited. There is a point at which markets will expect fiscal tightening, and beyond which delay becomes too costly or risky. The exact level remains uncertain, but the constraints tighten when political uncertainty increases or when the structure of government debt makes adjustment more painful. Van Nieuwerburgh's keynote highlighted the tension between the U.S.'s current privileged position and the fundamental economic risks that cannot be ignored indefinitely.





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