[Do Deficits Cause Inflation? A High Frequency Narrative Approach]

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This paper measures the causal effect of deficits on inflation using a "high frequency narrative approach". We identify an event that released news about the 2021 deficits in the United States—the Georgia Senate election runoff. We calculate the size of the shock using new narrative data from investment banks. We then study the high frequency response of inflation forecasts from asset prices, in order to separate deficits from other factors affecting inflation. We estimate an "inflation multiplier" of 0.19% price level growth over two years, for a 1% deficit-to-GDP shock. Our estimate implies that the 2021 deficits caused around a third of the 2021-22 inflation—meaning deficits were important but not the only cause. A heterogeneous agent New Keynesian model quantitatively matches the size and dynamics of the inflation multiplier.