

Speaker: Christoph Görtz, Birmingham

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Title: Is There News In Inventories?

(with Christopher Gunn and Thomas A. Lubik)

Abstract:

We identify total factor productivity (TFP) news shocks using standard VAR methodology and document a new stylized fact: in response to news about future increases in TFP, inventories rise and comove positively with other major macroeconomic aggregates. We show that the standard theoretical model used to capture the effects of news shocks cannot replicate this fact when extended to include inventories. We derive the conditions required to generate a procyclical inventory response by using a wedges approach. To explain the empirical inventory behavior, we consider two potential mechanisms, of which the presence of knowledge capital accumulated through learning-by-doing is preferred based on Bayesian estimation. The desire to take advantage of higher future TFP through knowledge capital drives output and hours choices on the arrival of news and leads to inventory accumulation alongside the other macroeconomic variables. The broad-based comovement a model with knowledge capital can generate supports the view that news shocks are an important driver of aggregate fluctuations.