ECONOMIC NARRATIVES AND REALITIES OF GEOPOLITICAL RISK

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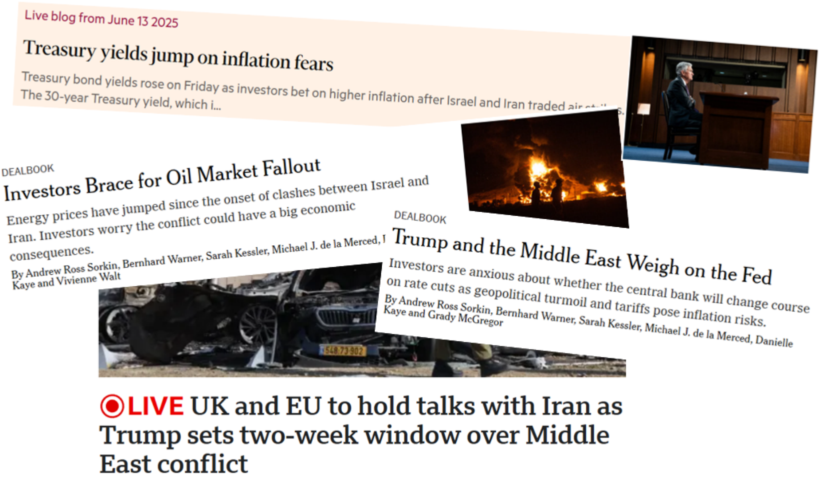
Rising geopolitical tensions pose challenges for monetary policy



Live blog from June 13 2025

Treasury yields jump on inflation fears

Treasury bond yields rose on Friday as investors bet on higher inflation after Israel and Iran traded air strikes. The 30-year Treasury yield, which i...

DEALBOOK

Investors Brace for Oil Market Fallout

Energy prices have jumped since the onset of clashes between Israel and Iran. Investors worry the conflict could have a big economic consequences.

By Andrew Ross Sorkin, Bernhard Warner, Sarah Kessler, Michael J. de la Merced, Kaye and Vivienne Walt

DEALBOOK

Trump and the Middle East Weigh on the Fed

Investors are anxious about whether the central bank will change course on rate cuts as geopolitical turmoil and tariffs pose inflation risks.

By Andrew Ross Sorkin, Bernhard Warner, Sarah Kessler, Michael J. de la Merced, Danielle Kaye and Grady McGregor

LIVE UK and EU to hold talks with Iran as Trump sets two-week window over Middle East conflict

A look into the literature: Mixed findings for inflation

Most studies find an inflationary effect of GPR:

- Caldara & Iacoviello (2022), Caldara et al. (2022)

But the impact depends on the type of GPR shock:

- Pinchetti (2024): GPR *energy* shocks are inflationary, *macro* shocks can be disinflationary.
- Bouoiyour et al. (2019): Only geopolitical *acts* raise oil prices.

The time period also matters:

- Asadollah et al. (2024): GPR shocks lowered inflation (1999-2010), but raised it (2010-2022).

Shocks to geopolitical risk: Not always inflationary

Negative Supply Shock: **Output $\downarrow$, Prices $\uparrow$**

- **Disrupted supply chains and global trade** raise production and transportation costs.
- **Cyber attacks & infrastructure destruction** disrupt economic activity and increase costs.

Negative Demand Shock: **Output $\downarrow$, Prices $\downarrow$**

- **Falling confidence** among consumers and investors
  $\rightarrow$ more saving, less spending $\rightarrow$ demand declines.
- **Financial accelerator**: Lower net worth increases default risk.

Positive Demand Shock: **Output $\uparrow$, Prices $\uparrow$**

- **Increased military spending** stimulates demand and inflation.
- **Onshoring**: Severed trade links bring production back home.

Measuring supply and demand narratives with ChatGPT

Negative supply:

- Does the article imply that **prices** of goods and services in the US have risen or will rise because of a geopolitical event?
- ...mention **supply-chain disruptions** affecting the U.S. economy?
- ...mention **trade flows** being redirected?

Negative demand:

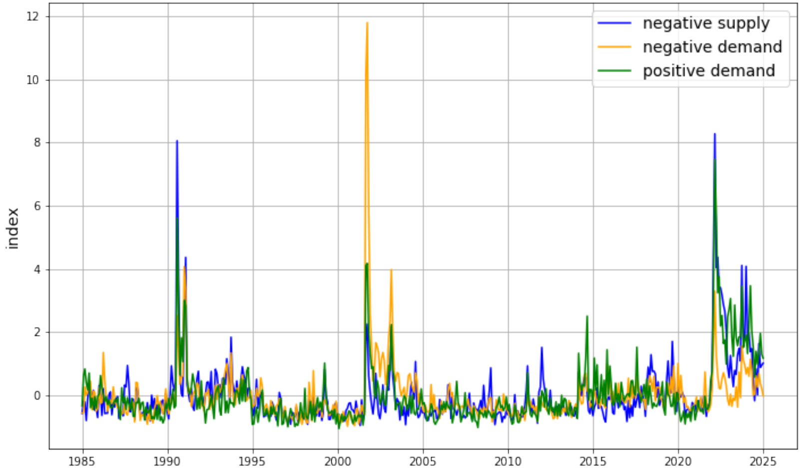
- Does the article say U.S. consumer, business, or investor **confidence** has fallen/will fall?
- ...say U.S. consumer, business, or investor demand has fallen/will fall?

Positive demand:

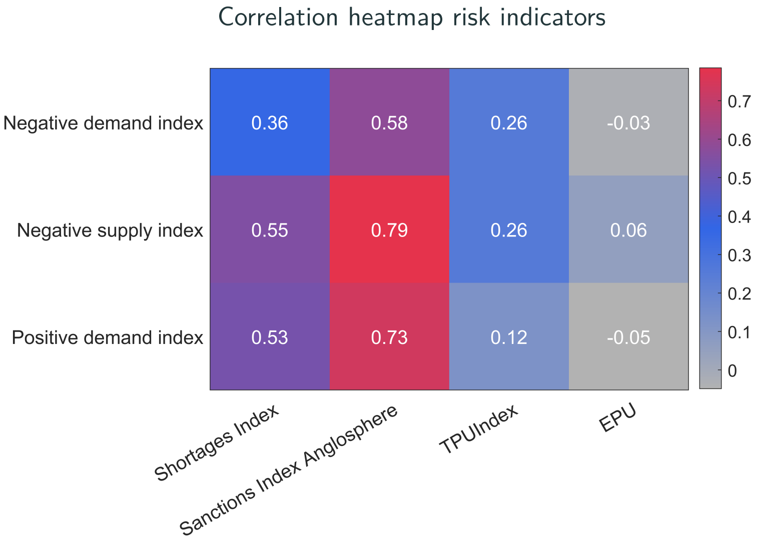
- Does the article imply U.S. **military spending** or defense production is increasing or planned to increase?
- ...imply **higher demand for U.S. goods/services** because of disruptions to trade or relative price changes?

Geopolitical events are framed in different economic narratives

Standardized GPR narrative indices



Narrative indices correlate with related risk measures



Output is less sensitive to the transmission channel than the oil price

Note: Impulse response after a 1-std shock in one of the three narrative indices. 68% credible sets.

Inflationary pressures are highest for negative supply GPR shocks

Note: Impulse response after a 1-std shock in one of the three narrative indices. 68% credible sets.

Conclusion

- We track supply and demand narratives in news about geopolitical risk using ChatGPT.
- Geopolitical events are reported through different economic lenses, shaping public perception.
- Narrative shocks have distinct macro effects:
  supply narratives drive inflation, demand narratives do not.

Thank you!

References

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