Discussion of "Liquidity Channnel of Fiscal Policy" by Bayer, Born & Luetticke

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IIES, Stockholm University, CEPR and IZA

Monetary Policy, Fiscal Policy and Public Debt in a Post COVID World
Banque de France and CEPR, Paris
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- What they find:
  - Empirical: fiscal expansions lead to a decline in the liquidity premium across asset classes
  - Quantitative: analyze temporary and permanent expansions in public debt
  - Policy Implications: Expanding public debt has a strong impact on the real

Why we should care

- Long debate about the size of fiscal multipliers and the impact of financing
- Advanced countries have seen massive increases in public debt
- Tries to provide a serious quantification of the liquidity channel of fiscal policy:
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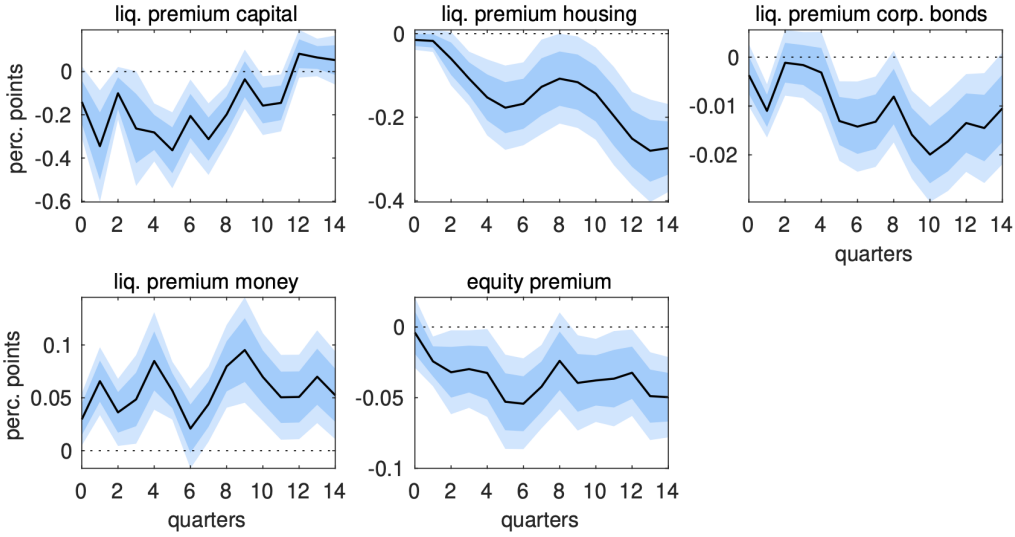
- But, I still have some questions...

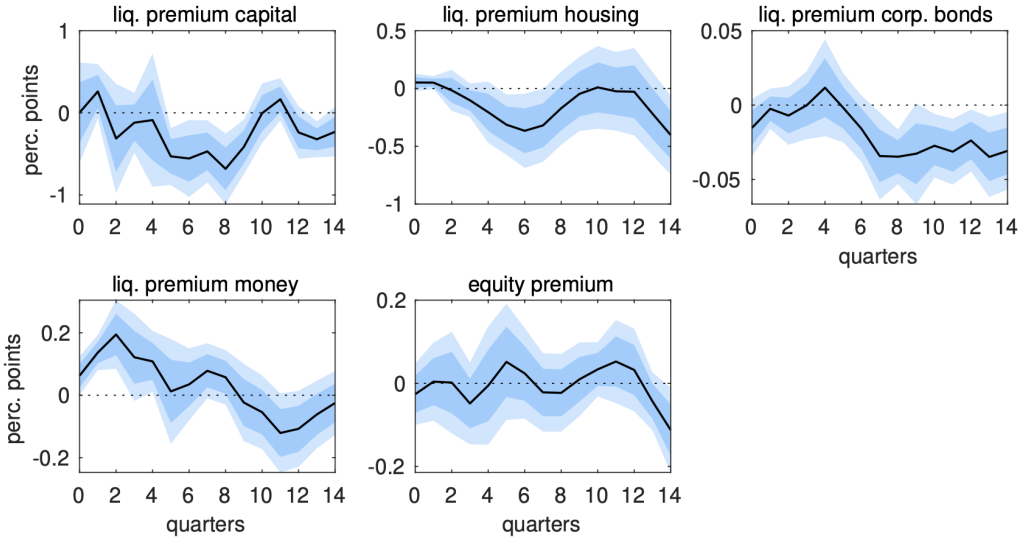
Empirics Part I: Blanchard-Perotti Shocks

Figure 2: Empirical Responses to Fiscal Spending Shocks: Return Premia

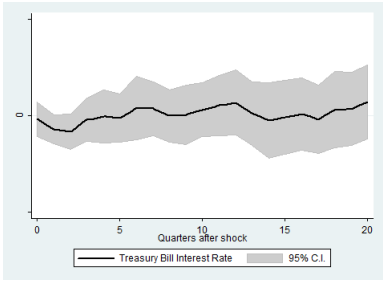


Empirics Part II: Ramey Shocks

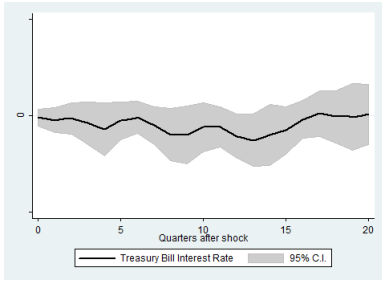
Figure 3: Empirical Responses to Military News Shocks: Return Premia



Monetary Policy Response?



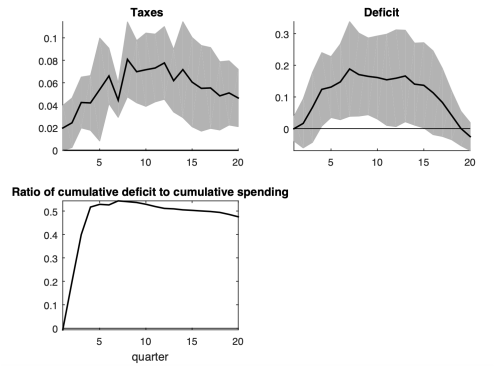
(a) Ramey-Zubairy Shock



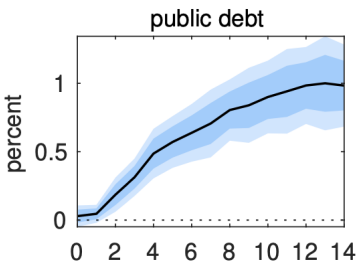
(b) Blanchard-Perotti Shock

In response to identified shocks, monetary policy appears to be passive...

Fiscal Response?



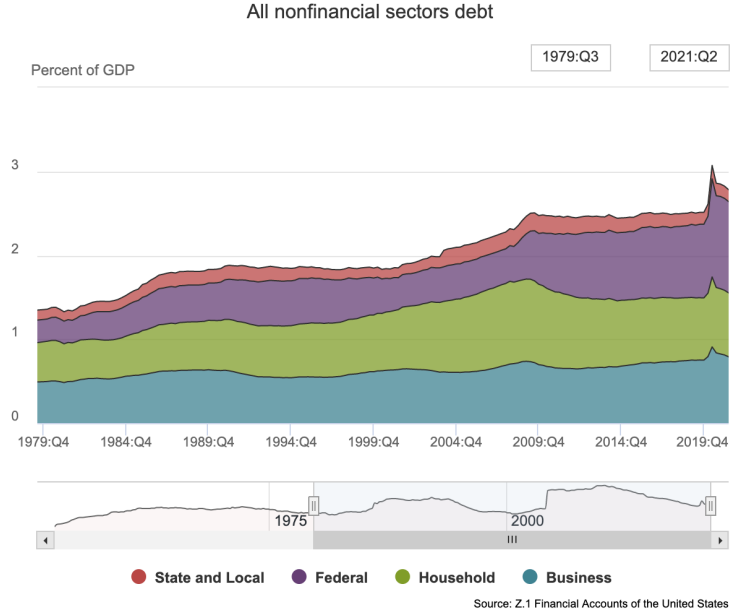
(c) Ramey-Zubairy Shock



(d) Blanchard-Perotti Shock

In response to identified shocks, looks like permanent expansion in debt...

How Much Liquidity?



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- How should we think about risk, other special roles government debt plays?

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- Debt rules (e.g. US and Germany) tend to be specified in terms of nominal debt levels
- Different implications for inflation and path of price level
- Unlike in Pierpaolo's paper, government debt here is net wealth, so movements in the price level would affect liquidity

The Investment Channel (Hagedorn-Manovskii-Mitman)

Denote aggregate private savings by:

$$S_{t+1}\big(\{T_l, \tau_l, w_l h_l, P_l, i_l^a\}_{l\geq 0}\big) = \int \frac{a_{t+1}(a, s; \{T_l, \tau_l, w_l h_l, P_l, i_l^a\}_{l\geq 0})}{P_{t+1}} d\Omega_t$$

Change in savings equals change in capital, bonds and adj costs:

$$(\Delta S)_{t+1} \quad = \quad (\Delta K_{t+1}) + (\Delta \frac{B_{t+1}}{P_{t+1}}) + (\Delta \Phi(K_{t+1}, K_t)).$$

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such that

$$K_{t+1} - K_{t+1}^{Crowd}$$

is the effect of the crowding out

Conclusion

- Very nice paper - brings the HANK literature to start thinking about long-run fiscal policy
- Made me think a lot of debt and liquidity
- Perhaps tighter link between the model and real world
- Looking forward to seeing the next version