

Discussion of *“Fiscal and Monetary Policy Interactions in a Low Interest Rate World”*
by Hofmann, Lombardi, Mojon and Orphanides

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Research questions

- Main question:
 - Can QE and fiscal policy help stabilize inflation and unemployment at the ZLB when long-term expectations are imperfectly anchored?
- Subquestions:
 - Does it help to announce a credible inflation target?
 - Do negative interest rates help?

Model

- Semi-structural model which combines several non-standard features
 - Extension of Orphanides and Williams (JME, 2007)
 - NKPC, modified IS-curve, monetary and fiscal policy
 - Occ. binding ZLB
 - Perpetual learning (imperfectly anchored long-term expectations)
 - QE (reduced form)
- Quantitative approach:
 - Calibrated model
 - Stochastic simulations: Baseline vs. “counterfactuals”

Findings

- Occ. binding ZLB destabilizes unemployment and inflation
 - Imperfectly anchored inflation expectations \Rightarrow risk of debt-deflation
- QE helps stabilize economy
 - Lowers long-term rates (by assumption)
 - Direct effect on unemployment (via IS curve)
 - Reduces debt-burden of fiscal authority \Rightarrow creates fiscal space
- Countercyclical fiscal policy helps stabilize economy
- Credible inflation target (anchored exp) and negative interest rates also help

Comments (1/4)

- Qualitatively, conclusions are not very surprising
 - Some are already well known:
 - ZLB increases macro volatility in NK models: e.g., Debortoli et al 2019
 - Others follow “by assumption:”
 - If QE mechanically lowers long-term rates and these directly enter the IS-curve \Rightarrow QE works!
 - Negative interest rates reduce volatility (lower bound binds less frequently).

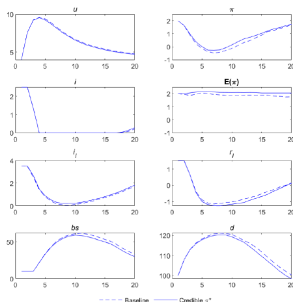
Comments (2/4)

- Quantitatively, much can be learned:
 - Model is arguably well-suited to analyze ZLB dynamics during GR
- Analysis relies on calibrated model
- Would benefit from formal estimation for three reasons:
 - 1 No “conventional” calibration
 - 2 Empirical validation of reduced form relationships (modified IS, QE etc.)
 - 3 Back out the shocks \Rightarrow “real” counterfactual analysis
 - For instance: “Empirical irrelevance of ZLB” \Rightarrow Mostly QE? Fiscal policy? Or anchored inflation exp?

Comments (3/4)

- Expectations channel appear muted:

Figure 6: Credible inflation goal in a deep recession



- Interpretation? Not much to gain from announcing credible target as it is already credible...?
 - What about confidence bands? Risk of debt-deflation?
 - Allow for time-varying gain?

Comments (4/4)

- Baseline ZLB binding frequency seems a little low
 - Without learning, it never binds

Table 1
Learning, the ZLB and r^*

	u	π	d	pb	ZLB
$r^* = 0.5\%$					
Mean	4.52	1.64	109.66	0.36	0.16
Std	0.89	1.67	12.64	0.78	
$r^* = 0.5\%$ <i>without learning</i>					
Mean	4.01	2.00	100.59	0.04	0.01
Std	0.52	1.40	5.52	0.60	
$r^* = 0.5\%$ <i>without ZLB</i>					
Mean	4.02	2.03	100.51	0.03	0.00
Std	0.56	1.61	6.68	0.62	

Questions

- Why do you replace short term rates with long term rates in the IS-curve?
- How do model-implied expectations align with survey data?
- Is QE always expansionary in this model?