

Discussion:
Income Inequality, Financial Crises
and Monetary Policy
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Studies the macroeconomic consequences of a credit crunch:

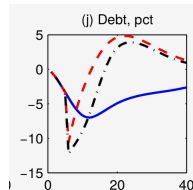
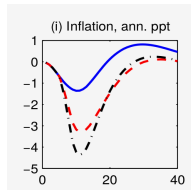
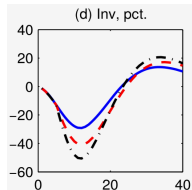
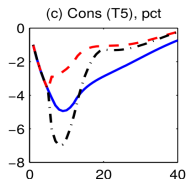
- Model with borrower and saver, nominal rigidity, and production
- Saver has preferences over financial wealth
 - Well-defined demand for government and private debt
- Borrower may default on private debt

Counterfactuals:

- Credit crunch with and without ZLB
- Optimal monetary policy rules

Credit Crunch a.k.a. Financial Crisis

- Sequence of “money demand” shocks
 - Government debt is in fixed supply
 - Excess demand for government debt
 - Inflation and nominal rate fall to clear gov. debt market
 - Output and investment declines



- Sequence of “money demand” shocks
- One-time “money supply” shock
 - Borrowers default on 5% of private debt
 - Excess demand for private debt
 - Inflation and nominal rate fall to clear private debt market
 - Potentially hitting ZLB
 - Output declines a lot

Optimal Policy Rules

- Strict inflation targeting increases probability of default
- Trade-off between minimization of variance and skewness of inflation
- Propose asymmetric loss function

Optimal Policy Rules

- Strict inflation targeting increases probability of default
- Trade-off between minimization of variance and skewness of inflation
- Propose asymmetric loss function
- Loss function is not derived from first principles
- How does welfare of borrowers and savers look like?

Utility cost of default

- All households in the bottom 95% draw the same realization of the utility cost draw
- More natural assumption for idiosyncratic default decisions
 - Calibrate cost distribution to match mean and variance of default probabilities

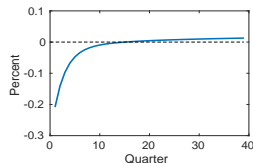
Excess demand for bonds is key mechanism

- Private debt: Incomplete markets offers a framework to endogenize supply and demand of private debt
- Public debt: Fiscal policy

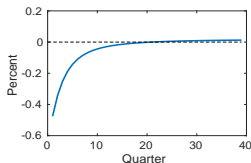
HANK model with portfolio choice (Bayer et al, 2017)

- 1 STD shock to household income uncertainty

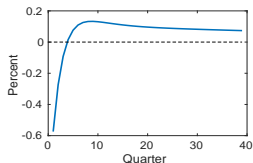
Output



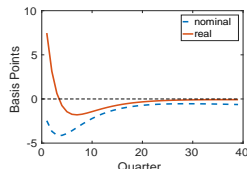
Consumption



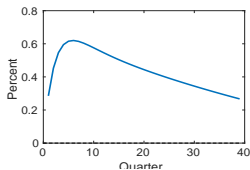
Investment



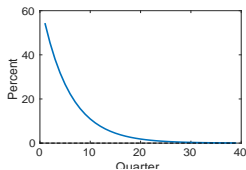
Nominal/Real rate



Bonds



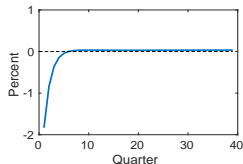
Uncertainty



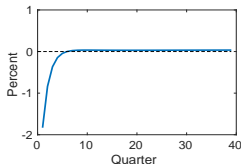
HANK model with portfolio choice (Bayer et al, 2017)

- 1 STD shock to household income uncertainty w/o stabilization

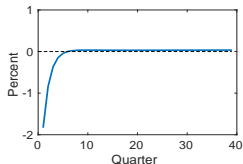
Output



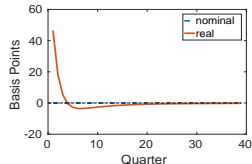
Consumption



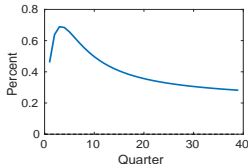
Investment



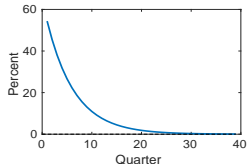
Nominal/Real rate



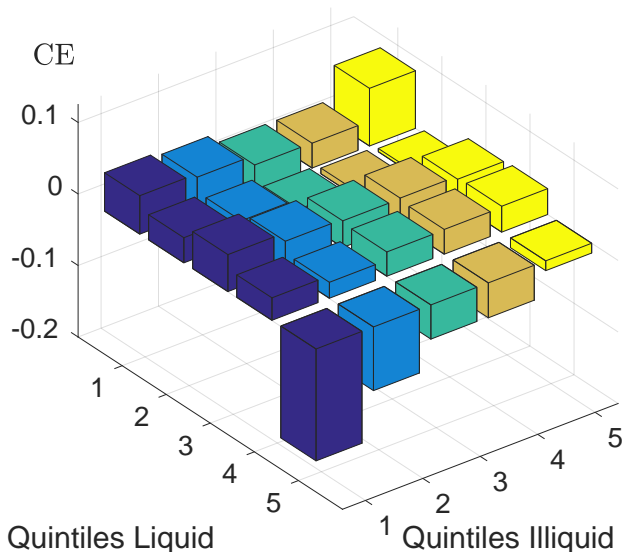
Bonds



Uncertainty



Welfare across portfolios (Bayer et al, 2017)



- Interaction between monetary policy and probability of financial crises is great!
- Going for HANK has two advantages:
 - More careful quantification of key mechanism
 - More palatable micro-foundation of savings and default decision