Comments on "A convenient truth: The convenience yield and implications for fiscal policy" by Dennis Bonam

Seonghoon Cho, Yonsei University

March 3, 2022, ADBI-ADB-KDI Conference
Outline

1. Summary of the Paper
2. Assessment and Comments
Countercyclical Fiscal policy may be beneficial

1. stabilize business cycle fluctuations and,

2. loosens debt sustainability requirements

Arguably the first to examine the tradeoff btw output and debt stabilization
Key Intuition

Wealth-in-the utility

- T-bond, a safe asset, in the utility just like money, generates complementarity btw bonds and consumption

- based on Krishnamurthy and Vissing-Jorgensen(2012)
- adopt specification of Rannenberg(2021)

Remark

1. Matter of belief: not yet standard
Surprising and contrasting to existing views

1. Standard New-Keynesian view
   - typically ignores fiscal aspects, or
   - mild multiplier effect in the short-run, but
     offsetting crowding-out effect dominates in the long-run,
   - (nearly) Ricardian

2. FTPL view
   - Active fiscal policy may stabilize output, and
   - stabilize debt as well with a completely different channel:
     - inducing higher expected inflation, lowering real rate.
This study

- does not focus on resolving a particular macroeconomic phenomenon
- presents a new "general" theoretical channel,
- is analytically strong, and logically consistent if one believes POSA

⇒ Faces a number of challenges
1. Need to compare with FTPL perspective, particularly in the ZLB regime, because both approaches argue a better tradeoff: stabilizing output (back to normal) and debt

- Policy mix in the present paper: AM-PF: endogenous interaction btw NK and Fiscal blocks
- Policy mix in FTPL: fiscal block independent of NK block (Ricardian), but debt affects output/consumption in the case of PM-AF mix, through expected inflation channel.

Question: Does the theory survive if $\phi_\pi = 0$?
2. Empirical Evidences on comovement between consumption and T-bond holdings

- For intuition building, empirical evidences or episode required
- CV story may not be a general result
- Then need to clarify the environment under which CV theory works.

3. Explicit specification on Convenience yield.

- Need risky asset to define CV in the model.
- Krishnamurthy and Vissing-Jorgensen(2012), Mehrotra and Sergeyev(2021)
Questions and Suggestions

4. Need to show the steady state analysis in the long-run

- A linearized short run equilibrium may not capture the household budget constraint restriction: SS analysis might be more convincing.

5. On policy advices (in line with this Conference)

- excessive demand for T-bonds: a unique phenomenon in U.S.?
  - Institutions hold T-bonds rather than HHs do.
  - CY generated by big foreign players?

- Existence of CV on government bonds in developing countries?

- What about Japan or EU?
Potentially an important contribution

- New perspective on business cycle and fiscal sustainability
  - Theoretical and empirical supports need to be stronger.
  - Narrow down the extent to which this proposal works.