Discussion of “Monetary policy and endogenous financial crises” by Cristina Manea

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Should central banks deviate from their objective of price stability to promote financial stability?

- (Timeless) key question still unresolved in **monetary economics**

- New bold attempt in this paper: incorporate nominal rigidities in an extension of Boissay, Collard, and Smets (JPE, 2016)
  - Heterogeneous firms: productive and unproductive
  - Financial frictions -> **leverage constraint**
  - Crisis due to **credit market stops**

- Main results
  - **Strict inflation targeting** performs surprisingly well
  - It can be improved by adding **financial variables** into the monetary policy rule
What type of crises are analyzed here?

- These are **not** crises linked to financial intermediaries, instead they are crises related to **inter-firm credit**
  - As capital grows, the return on capital declines, below a certain threshold credit freezes
  - Condition for a crisis

$$\Omega \frac{A_t N_t^{1-\alpha}}{M_t} < K_t^{1+\alpha}.$$
Comments

- Not all crises are alike
- On the role of demand shocks
- Inflation and rate dynamics in the model
- Trade-off crisis vs. inflation costs
- Related literature
Not all crises are alike

- Two types (discussed in the Appendix):
  1. Capital overhang (slow moving credit crises)
  2. Surprise large shock

- How do dynamics differ depending on the type of crises? Should the central bank respond in the same way?
Why don’t you show the dynamics of nominal rates, inflation and real rates around crisis?

Transmission in NK model with capital (and no adj. costs) is counter-intuitive, how relevant is that here?

Rupert and Sustek (JME, 2019)
Trade-off crisis vs. inflation costs

- Welfare analysis critically hinges on the calibration of the costs of inflation versus those of crises
  - Rotemberg costs calibrated to replicate the slope of the PC equivalent to Calvo with 4-quarters average duration of prices
  - Cost of financial crises equivalent to a 1.8% decline in output
  - Frequency of crisis 10%

- Cheap comment: How robust are results to those parameters?
On the role of demand shocks

- Why do you consider two types of shocks? Why not only TFP shocks?

- The demand shock $Z_t$ is an (inverse) risk premium shock:

  $$ (1 + i_t) = Z_t \left( 1 + i_t^b \right), $$

  why? (What does it mean that bond yields are below policy rates?)
Related literature

- How does your model relate to Marbet (2022)?
  - NK model with crises à la Boissay, Collard, and Smets (JPE, 2016)

- Other papers analyzing monetary policy with financial crises
  - Rottner (2022), Van der Gothe (2021)
Conclusions

- **Great paper**: important question, superb execution

- **My two cents:**
  - If the paper aims at being descriptive (proof of concept of a mechanism), I suggest investing more on explaining what is going on.
  - If instead it focuses more on **quantitative results**, I would show the robustness of the results (several moving parts).