Discussion of

# The Limited Power of Monetary Policy in a Pandemic

**by A. Lepetit and C. Fuentes-Albero**

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XI BIS CCA Research Conference, November 18, 2021

# The Paper

- Question: How effective is monetary policy during a raging pandemic?

- Answer: Not much effective.

- Framework: Standard New Keynesian model with standard epidemiology bloc (SIR):
  - Two-way interaction between macroeconomy and epidemic.

# The Paper

- Key result I: Accommodative monetary policy less powerful during raging pandemic.
  - Intuition: consumption activities generate infections → households reduce consumption to reduce infection risk.
  - Epidemic dynamics of first order importance for consumption. Real interest rate channel muted/less efficatious.
  - Monetary policy better suited to support recovery once the pandemic wanes.
  - Important to model two-way interaction of macro-epi.

# The Paper

- Key result II: Welfare analysis suggest monetary policy should keep hands off economy during raging pandemic.
  - Intuition: infection externality -> households don't adjust consumption enough in competitive equilibrium compared to planner solution.
  - Monetary accommodation moves output in 'wrong' direction, i.e. away from planner solution which takes infection externality into account.

# The Paper

- Very interesting and inspiring paper.

- Lots of great food for thought.

# The Power of Monetary Policy

- Key takeaway of Lepetit and Fuentes-Albero paper:
  - Power of monetary policy limited during raging pandemic.
  - Real interest rate channel muted.

- Stark contrast to conclusions by Ascari, Colciago and Silvestrini (2021, Business Dynamism, Sectoral Reallocation and Productivity in a Pandemic, DNB).

# Ascari, Colciago and Silvestrini (2021)

- New Keynesian model with two sectors and epi dynamics:
  - Infectious and non-infectious consumption sector.
  - Two-way interaction between epidemic and macroeconomy.

- Key result: model implies monetary policy can be very powerful even in a raging pandemic:
  - Intuition: real rate drop stimulates non-infectious consumption.
  - Sectoral reallocation and less severe recession.
  - Powerful real interest rate channel.

# The Power of Monetary Policy

- One vs. two sector model setup seems crucial for conclusions about quantitative effects of monetary policy during pandemic.
  - More quantitative analysis much welcome.

- Both models also differ somewhat in terms of nominal rigidities, epi-macro setup, monetary policy, ZLB etc. How important are these for the different conclusions?

# Optimal Policy

- Quantitative analysis on government containment measures to deal with epi infection externality not considered (so far).
  - Optimal simple containment (one instrument).
  - Optimal smart containment (multiple instruments).
  - How does optimal containment look like in the model?

# Optimal Policy

- How does Ramsey optimal monetary policy during a pandemic look like with and without optimal epi containment?
  - Optimal monetary-containment policy mix.
  - Epidemic works trough supply and demand channels.
  - Depending on strength of either channel, inflation and output can move in same or opposite directions. Tradeoff for monetary policy possible.

# Further Remarks

- Baseline simulation captures salient facts of the pandemic and recession. Focus on quantitative match of model vs. data would be welcome.

- Why does the central bank react to output in deviation from steady state and not to output in deviation from flexible price output?

# Further Remarks

- Modeling of shocks to transmission function (pis1, pis2, pis3) opaque and unclear.
  - Time indices missing. How do these shocks look like? How important are they for the baseline? How can these shocks be measured from the data?

- Figure 6 indicates that forward guidance mostly pushes inflation up in a pandemic. That‘s an interesting result that deserves more spotlight.

# Further Remarks

- Add infections curve to Figures 3-5 to help reader understanding state of epidemic over time.
- Plot steady state inflation and interest rates in Figure 2.
- Why condition forward guidance on two quarters?

- Very interesting and inspiring paper.

- Lots of great food for thought.