Discussion of
The Limited Power of Monetary Policy in a Pandemic
by A. Lepetit and C. Fuentes-Albero

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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.
• **Key result I:** Accommodative monetary policy less powerful during raging pandemic.
  
  – **Intuition:** consumption activities generate infections \(\rightarrow\) households reduce consumption to reduce infection risk.
  
  – Epidemic dynamics of first order importance for consumption. Real interest rate channel muted/less efficacious.
  
  – 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 through 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.