Discussion of
“Makeup Monetary Policy Strategies in an Unequal World”
by Martin Bodenstein, Nils Gornemann and Jae Sim

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Summary

- In representative-agent models, “makeup” strategies desirable to deal with ZLB
  - Question: Do makeup strategies work also in a model with heterogeneity?
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  - Workers and entrepreneurs
  - Search-and-matching labor market frictions
  - Wealth in the utility function

Two main results:

1. Inequality weakens stabilization power of monetary policy
2. Makeup strategies particularly powerful with significant heterogeneity
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Amplification

- HANK $\Rightarrow$ Significantly worse impact of negative demand shock

- Key reason: Few liquid assets and limited access to credit
  - Hard to self-insure
  - Consequence: Large fall in consumption
    - Unemployed $\Rightarrow$ Lower income
    - Employed $\Rightarrow$ Precautionary savings

- Conjecture: Countercyclical inequality (higher in recessions)?

- Should exploit richness of setup to explore implications beyond aggregate variables
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Why do makeup strategies work (so) well?

PLT and NGDP targeting embed expectations of “low for longer”

- Expectations of higher future inflation in a recession
- Lower actual real rate even when nominal rate is at ZLB
- Stimulate demand and speed up recovery

Makeup strategies

⇒ Systematize forward guidance

- Lesson in Eggertsson and Woodford (2003) robust to introduction of heterogeneity
- Although with a large share of true hand-to-mouth sensitivity to real rate should decline
**Policy**

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Price Level Targeting vs. Inflation Targeting

Price Level Targeting

Inflation Targeting

Shock

2%
Forward Guidance Puzzle

- Forward guidance very powerful in RANK
  - In fact, too powerful ⇒ Forward guidance puzzle (Del Negro, Giannoni and Patterson, 2012)

\[ x_t = -\tilde{\sigma}(i_t - E_t \pi_t + 1 - r^*_t) + \delta E_t x_{t+1} \]

But \( \delta < 1 \) only if inequality is procyclical (Bilbiie, 2019)

⇒ In which case, heterogeneity dampens effect of shocks (opposite of this paper)
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![Graph showing equivalized household earnings over time with shaded areas indicating NBER recessions.](image)
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Does wealth in the utility function dampen power of PLT?

In Bilbiie (2019), no forward guidance puzzle with countercyclical inequality and PLT

Makeup strategies intrinsically different from forward guidance?

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- Or a fundamental difference?
  - Systematic nature of makeup strategies avoids over-reaction (not a shock)?