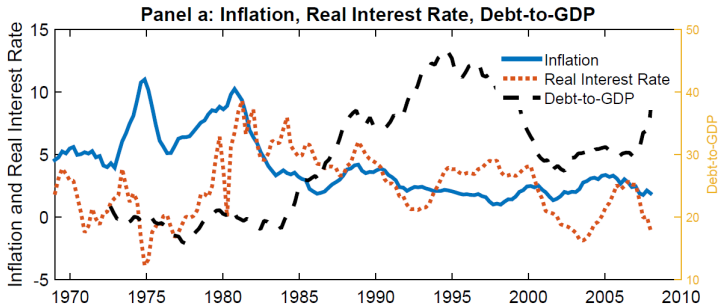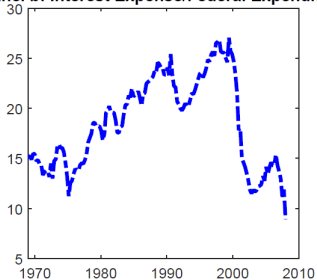# Discussion on "Controlling Inflation with timid Monetary-Fiscal regime Changes"

by Guido Ascari, Anna Florio and Alessandro Gobbi

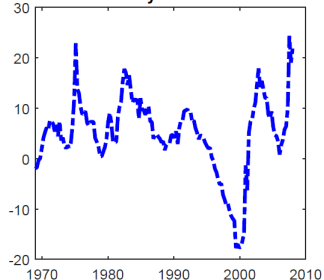Discussion by Kostas Mavromatis

De Nederlansche Bank

Panel a: Inflation, Real Interest Rate, Debt-to-GDP

- Inflation
- Real Interest Rate
- Debt-to-GDP

Panel b: Interest Expense/Federal Expenditure

Panel c: Primary Deficit/Federal debt

Literature

- Inflation and FP: Bhattarai et al. (2014), Leeper (1991), Sims (2011).

- MP-FP mix and MS: Bianchi & Ilut (2017), Bianchi & Melosi (2013), Bianchi (2012), Davig and Leeper (2011) .

This Paper

- Characterization of the properties of the model when MP and FP switch over time.

- Long-run fiscal principle; conditions FP needs to satisfy for a unique RE equilibrium in a MS environment.

- **Coordination:** MP and FP coordination within and across regimes.

Results

- ▶ Classification of deviations

  1. *Overall AM/PF mix*: only timid deviations from initial stance.
  2. *Overall switching mix*: substantial switch in both MP and FP.

- ▶ No wealth effects, even after timid deviations and full knowledge.

- ▶ Wealth effects, under substantial deviations.

Long-Run Fiscal Principle

- *Given an active MP, FP is such that no wealth effects exist in either regime.*

- A "well behaved" MP allows for timid deviations in FP, and the dynamics remain Ricardian.

Digging into the Results

- Given a symmetric regime duration, asymmetric deviations can lead to indeterminacy.

- An overall passive FP needs to be accompanied by an overall active MP to yield determinacy of the global equilibrium.

- Symmetry in deviation is important; this can lead to determinacy of the global equilibrium even if the economy is switching between an AM/AF and a PM/PF.

- Long-Run Taylor Principle fails when FP is not overall passive.

- In a MS environment the intervals of the MP and FP coefficients widen. This is because of the prob of a switch (and hence because of agents' beliefs).

Policy Implications

- *Timidity trap;* substantial policy deviations from an AM/PF regime necessary to reflate the economy (assuming no distortionary taxes etc...)

- *Normal Times;* AM/PF dominant regime in order to anchor inflation expectations even when the economy switches temporarily to a PM/AF regime.

- *ZLB;* substantial deviations in FP as well to get determinacy when ZLB is short lived. Calendar-based forward guidance associated with persistent deviations from an AM/PF regime.

Comments

- Can probabilities be such to allow for asymmetries in the two policies (asymmetric deviations)?

- Can you distinguish between a *switching mix* with low probability and an *overall AM/PF mix*?

- Are you really identifying the ZLB by setting $\gamma_\pi = 0$?

- Not so sure about the connection between the BVAR and your theoretical IRFs.

- Davig & Leeper (2007) solve the model differently so new conditions on the MPF might be needed.