

Monetary Policy and Redistribution in Open Economies

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The views expressed here do not necessarily reflect the position of Bank of Lithuania or Eurosystem

- This is a very interesting paper on an important topic, where Guo, Ottonello and Perez (GOP below) provide insights that should be valued by both scholars and policymakers.
- The issue of interest is a classic one—the distributional impacts on household of international integration.
 - A large literature on trade integration and labor market outcomes, but much less is known in international macro
- GOP develop a small open economy HANK model to investigate the three classic questions in international macro, with a focus on distributional impact (consumption).
 - ◇ What are the effects of domestic monetary policy in open economies?
 - ◇ What are the spillover effects of foreign demand and monetary policy shock?
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- GOP embed rich heterogeneity in their framework to capture the uneven international integration across households:
 - Heterogeneity in **income and wealth**, as in Kaplan et al (2018)
 - Heterogeneity in **real integration**, as in Obstfeld and Rogoff (2000)
 - Heterogeneity in **financial integration**, as in Maggiori et al (2017)
- GOP's answer:
 - ◇ What are the effects of domestic monetary policy in open economies?
 - Differences in **income and wealth** are the main source of C dispersion (HtM)
 - ◇ What are the spillover effects of foreign demand and monetary policy shock?
 - Foreign demand: **real integration** is the main driver (T, NT)
 - Foreign monetary policy: **financial integration** is the main driver (r, r^*)
 - ◇ How do alternative exchange-rate regime compare? On impact,
 - $\Delta_C(\text{flexible ER}) < \Delta_C(\text{fixed ER})$, $\sigma_C(\text{flexible ER}) > \sigma_C(\text{fixed ER})$
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- Assets
- Unpacking
- Rival story

- There are two assets in the model (q_D, q_E), both are zero-coupon bonds, but essentially, they are the same type of asset with same level of liquidity.
- There's an important difference between GOP and Kaplan et al (2018)
 - Agents in Kaplan et al(2018) have two types of assets: liquid vs illiquid.
- The illiquid asset is important for at least two reasons:
 - ◊ Model fit
 - One-asset model can generate high average wealth or high MPC, but not both
 - ◊ Shock transmission
 - One-asset model abstracts from capital, and the responses of quantity and price of capital greatly matter for the monetary transmission (through the indirect channel)
- Missing illiquid asset in GOP leads to an amplified C dispersion
 - Poor HH with high MPC, rich HH with not high enough MPC

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- **Item 1:** There are many moving parts in the model, but what seems to be missing is the interaction between the **three heterogeneities** and **MPC heterogeneity**.
- **Why?** Ignoring their interactions could potentially lead to an **exaggerated** quantification of a certain channel.
- For example, it could well be the case that households with **high financial integration** also have lower MPC.

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Comment 2: Unpacking

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Table 3: Distributional Effects of Aggregate Shocks

	Domestic monetary shock	Foreign demand shock	Foreign monetary shock
<i>Panel 1. Cross-section dispersion of individual consumption responses</i>			
Standard deviation	0.25	1.47	3.21
Interquantile range	0.30	1.20	1.64
90-10 percentile range	0.50	4.54	10.37
<i>Panel 2. Variance decomposition of the cross-section dispersion (%)</i>			
Real integration	1.1	54.4	19.5
Financial integration	1.2	0.8	26.2
Net wealth	36.3	2.8	19.7
Idiosyncratic labor income	34.2	0.4	0.8

- **Item 2:** Benchmark seems to suggest **an expansionary monetary policy** leads to an **increase in consumption dispersion**
- **Why?** If higher consumption dispersion implies higher consumption inequality, then this result is in direct contradiction with existing literature.
 - Coibion et al (2017, JME) find contractionary monetary policy increases consumption inequality
- Alternative measure of consumption inequality?
 - Consumption Gini index?
- On a related point, I'm also curious to see the IRFs of consumption by integration type
 - Besides C_N, C_{NT} , also $C_{N,FI}, C_{N,FNI}, C_{NT,FI}, C_{NT,FNI}$, maybe even their gap to C

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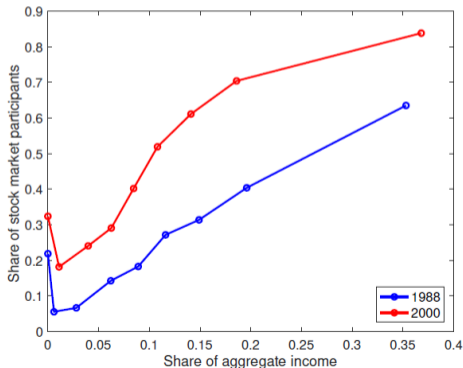
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- However, monetary policy also affect the stock market, if not even more, dramatically
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Comment 3: Rival Story

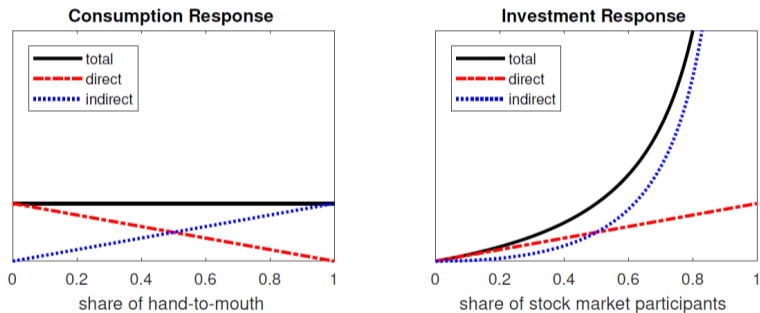
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- Melcangi and Sterk (2020) build a NK-HA model, in which high-income households (low MPC) invest their savings in stock
 - The model even overfits the top 1%!
- From the firm side, the rise of FDI(cross-border M&A) has been a major component of financial globalization
 - Financially integrated households purchase shares of foreign firms

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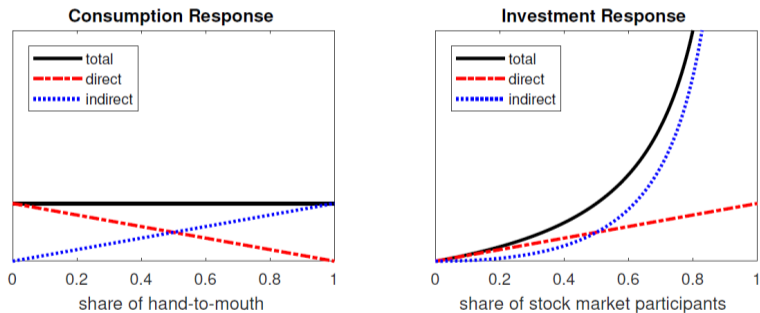
Figure 1: Effect of an interest rate change on aggregate consumption and investment.



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- I enjoyed a lot reading this paper!
- I would at least:
 - Acknowledge the limitations of working with only liquid asset and perhaps re-evaluate the quantitative implications of the model
 - Unbundling the rich heterogeneity and their interactions with MPC
 - Clarifying the seemingly conflicting results on consumption inequality with the existing empirical evidence
- I look forward to reading more papers from GOP!