# Discussion of "Optimal Macroprudential and Monetary Policy in a Currency Union" by Dmitriy Sergeyev

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Complex question because

- Interactions: monetary policy affects borrowing, macropru affects output
- Asymmetries: monetary policy cannot achieve full stabilization in monetary union
- Coordination: Open-economy spillover effects

Dmitriy studies this question in a open-economy model with

- non-traded goods, traded goods, and durable goods
- nominal rigidities
- demand for safe assets
- collateral constraints on safe debt issuance for banks
- reserve requirements as macroprudential tool

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   - even without monopoly power over TOT

# Start Simple - Closed Economy

Two externalites:

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$$\tau_0^b = \frac{1}{1-\tau_0}\left(\frac{\epsilon^\Gamma \tau_A}{1+\tau_A} - \tau_0 Z_2\right) \qquad Z_2 > 0$$

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E.g. If AD is inefficiently low ($\tau_0 > 0$), $\tau_0^b$ is lowered to stimulate banks' investment in durable goods, hence AD

# Now Not So Simple - Open Economy

Two additional externalities as debt issuance affects $P_1^{NT}/P_1^{T}$ which

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2. enters SAIA constraint

One more externality as debt issuance affects total spending across goods produced by different countries (as in Farhi Werning 2017)

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- No coordination: country $i$'s macropru tax trades off 5 externalities
- Coordination: MP sets average labor wedge to zero (as in Gali-Monacelli, 2008), macropru taxes set to address remaining externalities, taking into account inefficient int'l spillovers

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  - or in combination with AD externalities (Korinek Simsek 2016, Farhi Werning 2017)

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Key insight:

- With asymmetric countries, monetary authority is generally not able to stabilize AD in every country of the union
- You can (and want to) use financial taxes to affect borrowing and in turn AD!

# Fiscal Unions and Macroprudential Policy

- Some commentators view fiscal union in Europe as essential for the well functioning of the monetary union
  - in practice very difficult to implement
  - doesn't address externalities arising within financial sector
- Dmitriy offers an alternative/complementary tool to deal with asymmetries, leveraging <u>interaction</u> of financial and AD externalities

Raises interesting questions this model could answer

- Are there conditions under which optimal macropru policy makes fiscal transfers unnecessary?
- If not, when is it more desirable to have access to both tools?

# The Macroprudential Tool

Macroprudential tax is implemented via reserve requirements (RR) or interest on reserves (IOR)

$$\tau_0^b \equiv \frac{z_0}{1-z_0}\frac{i_0 - i_0^r}{1+i_0^r}$$

1. Policy would require to set country-specific RR or IOR

Institutional and political constraints for implementation?

Even if feasible, could banks circumvent local regulation?

- e.g. banks operating across borders could concentrate reserve holding in country with highest IOR / lower RR.
- Ceterolli Goldberg (2012) provide evidence that **global banks** manage liquidity on global scale, insulating themselves from changes in domestic (monetary) policy.

# Spillovers and Coordination

- 3 international externalities create role for coordination
  - externalities work through GE effects of safe debt issuance on relative price of non-traded goods
- **Financial integration** in markets for banks' assets and liabilities makes balance sheet constraints highly correlated across countries
- In the model, banks invest in durable goods only domestically. What if they could also invest abroad?
- Could have important implications for role of coordination
- Dedola et al. (2013) show that with financial integration, positive policy spillovers lead to free-riding problem resulting in suboptimal credit policy in an open-economy Gertler-Karadi (2011) model

# Digging Deeper

Optimal policy is characterized in terms of objects ($Z$'s)

Nice and intuitive characterization of policy trade-offs in terms of externalities

However, $Z's$ depend on optimal allocation and deep parameters

Hard to see how they change with the environment

Some examples could elucidate the strength of the forces at play and answer the following (and other) questions:

- How does the macropru tax respond to different shocks?
- How do gains from coordination depend on the degree of economy openness?

# Conclusion

Very nice paper on an important and timely topic. I enjoyed reading it!

Could connect more closely to the fiscal union literature

Challenges for implementation/effectiveness of local macropru policy in a world with

- global banks
- financial integration

Desirable to do more numerical examples and comparative statics