Monetary policy and the revaluation of debt

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Motivation

- Dollar = unit of account for many nominal debt contracts
  - inflation ⇒ lower real value of dollar, nominal promises
  - wealth effects: good for borrowers, bad for lenders

- Two types of revaluation shock
  - surprise inflation: unanticipated increase in price level
    - same % drop in real value for all promises, regardless of duration
  - surprising news about \textit{future} inflation
    - e.g. central bank announces higher inflation target
    - smaller % drop in promises with short duration
    - promises with short duration not affected by inflation in far future

- This talk
  - measurement of nominal position & exposure to revaluation shocks
    update of Doepke & Schneider 2006 JPE
  - aggregate & welfare effects in a model with heterogeneous households
    Doepke-Schneider-Selezneva 2018
Sectors, asset & net nominal positions

- Net Nominal Position (of a sector or individual household)
  \[ NNP := \text{nominal assets} - \text{nominal liabilities}. \]

- Sectors
  - consider: households, government, rest of the world
  - consolidate: business, including financial intermediaries.

- NNP contains
  - nominal assets held indirectly through mutual funds, DC pension funds
  - nominal debt owed indirectly through ownership of equity

- Data
  - Flow of Funds Accounts → sectoral positions
  - Survey of Consumer Finances → distribution of households

- Construct payment streams for all nominal instruments
  - restate positions at market value
  - measure duration by position: important for revaluation exercises
Net nominal positions by sector, % GDP

- Red line: government
- Blue line: households


Values: -60, -40, -20, 0, 20, 40, 60
Net nominal positions by sector

- government
- households
- rest of the World

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04/10 6 / 26
Net nominal positions by sector, % GDP

- Government
- Households
- Rest of the world

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Household nominal positions: role of indirect debt

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Household nominal positions: role of indirect debt
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Revaluation shocks

- Inflation episode: 5% higher inflation for 10 years
- Two thought experiments
  - surprise inflation: one time unanticipated increase in price level
    - same % drop in real value for all positions; upper bound
  - surprising news about future inflation
    - smaller % drop in promises with short duration; lower bound
- Gains & losses on gross household positions
  - compute hypothetical gains & losses for each date
    - surprise inflation: gains < losses – households net lenders
    - surprising news: gains > losses recently – hh lend short, borrow long
- Net gains by group of households for SCF year 2013
  - consider only news: what if higher inflation target announced in 2013
    - rich = top 10% NW, poor = bottom 20% NW, middle class = rest
    - redistribution: old rich ⇒ young middle class
Losses on zero coupon bonds by maturity in %

- surprise inflation
- surprising news about future inflation

Real loss vs. Maturity

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Gross household positions, % GDP

- Losses: surprise
- Gains: surprise

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04/10 15 / 26
Gross household positions, % GDP

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Redistribution among household groups, % GDP

age at policy announcement
30 40 50 60 70
-1 -0.5 0 0.5 1
middle class
rich

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04/10 19 / 26
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- How do people respond? Study aggregate & welfare effects in model!
Model overview

- Small open economy; no aggregate uncertainty
  - leisure, housing services, other consumption (numeraire)

- Housing
  - indivisible units differ by service flow; baseline: fixed distribution
  - competitive markets for service flow (rent), houses (house prices)

- Other assets
  - borrowing & lending at world interest rate
  - collateral constraint: borrowing \( \leq \) house value * (max LTV)

- Overlapping generations of households
  - differ in preferences: discount factor, housing tenure
  - differ in skills: permanent differences + idiosyncratic shocks
  - warm glow bequests

- Rest of economy
  - competitive CRS firms produce numeraire from capital & labor
  - government: income tax, spending, social security
Quantitative exercise

- Calibrate to aggregates & SCF data for 2013
  - match income & portfolios by age & net worth
- Revaluation shock: unanticipated increase in inflation target
  - 5% for 10 years: real wealth transfers by group of household
  - also gains for government & households, loss for rest of the world
  - redistribution occurs only in first period
- Compute transition path
  - impulse responses for individual actions, aggregates, welfare
  - fiscal policy: gradually adjust spending towards new steady state, income tax adjusts to satisfy budget constraint
- Aggregate effects if responses of winners & losers do not cancel
  - winners younger & have lower MPCs: consumption falls
  - losers retired, winners working: labor supply falls
  - persistent effects: propagation via wealth distribution
Redistribution among household groups, % GDP

age at policy announcement

middle class

rich
Aggregate consumption & output (% steady state)
Welfare by group (% equiv. consumption for life)

- Renters
- Middle class
- Rich

Age at policy announcement:
- 30
- 40
- 50
- 60
- 70

Renters' welfare decreases significantly with age, while middle class and rich groups show more stable welfare patterns.
Conclusion

- Monetary policy as a revaluation shock
  - large gains for government, losses for foreigners
  - large heterogenous welfare effects
    - net borrowers win, especially middle-aged middle class
    - net lenders lose, especially rich retirees
  - moderate but persistent changes in aggregates
  - role of housing if fixed factor
    - savings responses move house prices, not capital stock
    - price move at high end: middle class tries to upgrade

- Movements in real interest rates
  - matter in closed economy, especially with nominal rigidities
  - wealth effects + income & substitution effects (Auclert 2018 AER)

- Price stability & choice of unit of account
  - Doepke-Schneider 2017 Ecma: why a dominant unit of account?
    - coordination minimizes mismatch of assets & liabilities in credit chains
    - optimal unit comoves with assets of likely borrowers & is stable in value
  - recent literature in international finance on choice of dollar