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Comments of "QE in the Future: The Central Bank's Balance Sheet in a Fiscal Crisis"

Christopher Sims
Princeton University

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Looking at the forest

- Fully understanding the paper's model requires going through quite a bit of technical detail.
- The model is nonetheless in many respects highly simplified — just one and two period debt; price stickiness that lasts just one period; real currency balances in the private utility function in a way that implies a planner could achieve arbitrarily high representative agent utility via steady deflation; no real capital that lasts between periods, etc.

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- But the paper's main qualitative conclusions seem to me likely to be robust across a variety of models.

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2. By affecting how severely the government must default if fiscal shocks are absorbed by default on interest-bearing debt.

   This matters, because reduced real value of government bond collateral has effects through financial frictions.

Without default

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- The paper argues that QE is not equivalent to duration management by the treasury.
- This claim rests on assuming that the treasury could not coordinate with the central bank interest rate policy.
- But the good effects of QE here also depend on monetary-fiscal cooperation: The treasury must refrain from undoing the effects on private sector durations of the central bank QE operations.

With default

- The paper assumes default on reserve deposits is impossible, whereas on long or short bonds it is possible.
- For both reserve deposits and nominal government bonds, there is never any *need* for default — these liabilities promise only to supply paper to creditors.

Are reserves truly immune to default?

- Reserve deposits have easily verified ownership and amounts, and are thus feasibly taxed, whereas currency does not, which might motivate limits on conversion of reserve deposits to currency.

- The question is, whether a fiscal authority desperate to meet current obligations would find no way to spread default to reserve liabilities if it were defaulting on its other liabilities.

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- The question is, whether a fiscal authority desperate to meet current obligations would find no way to spread default to reserve liabilities if it were defaulting on its other liabilities.
- So this asymmetry between reserves and short bonds is not so obviously strong as the paper assumes.

Is the paper's model well-suited for considering current large central bank balance sheets?

- The "crisis" in this model is an inflationary fiscal shock.
- The positive effects of QE in this model arise from its effects in the presence of a future crisis arising from an inflationary fiscal shock.

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- The "crisis" in this model is an inflationary fiscal shock.
- The positive effects of QE in this model arise from its effects in the presence of a future crisis arising from an inflationary fiscal shock.
- Actual current large central bank balance sheets arose in response to *de*flationary financial shocks.
- We might therefore be interested in analysis of the consequences of a large, long-duration central bank balance sheet if we confronted a new deflationary financial shock.

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- Though we don't have good macro models that integrate formal micro-founded liquidity variation, many economists would agree that the initial liquidity-injection component of QE (QE I in the US) was more clearly beneficial than the later expansions.

Not in the paper: amplified quasi-fiscal effects

- Central bank independence and the professionalization of inflation policy rests on a convention that fiscal impacts of central bank monetary policy are not ordinarily a subject for debate or negotiation between the central bank and the treasury.

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- Central bank independence and the professionalization of inflation policy rests on a convention that fiscal impacts of central bank monetary policy are not ordinarily a subject for debate or negotiation between the central bank and the treasury.

- Large fluctuations in seigniorage, especially if it enters negative territory, can weaken this convention.

- If the central bank's balance sheet includes private sector liabilities, its policy, like ordinary fiscal policy, starts to involve picking winners and losers — whose liabilities will get central bank support — and thus also increases the temptation for fiscal authorities to second-guess central bank decisions.

Conclusion

- The paper has identified a set of conditions and assumptions under which a large central bank balance sheet could be useful, and these conclusions are not as sensitive to the details of model specification as a casual reading might suggest.

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- But the considerations the paper ignores may be more important than those it treats.

- If the main benefit is QE is easing of a temporary liquidity shortage, and if its main cost is persistent amplification of quasi-fiscal effects of central bank decisions, there is a strong argument for reducing the balance sheet as soon as it is feasible.