

# Discussion of “Timing Fiscal Retrenchment in the Wake of Deep Recessions” by Corsetti et al

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- Resurgence in fiscal policy research
- Sovereign risk premium a key channel
- General-equilibrium modelling approach vital

# Key Transmission Mechanism in Model

- Corporate bond yield an average across sovereign yield and risk-less interbank rate
- CB can reduce interbank rate to offset increase in sovereign yield
- But cannot do this if target rate is low: *ZLB* problem
- Implies feedback from *SRP* to output at *ZLB*
- (Fiscal Indeterminacy problem)

# Links between SRP and Private-Sector Cost of Credit

- Main channel is banking sector
- Large, export-orientated corporates might be insulated
- GS: Portuguese 5-year corporate bonds 130bps below sovereign

# Fiscal Strategies in a Deep Recession

- *Immediate Implementation*
  - Trade off: Decline in risk premium against recessionary impact
- *Late Implementation*
  - Decline in future short-term interest rate implies reduction in long-term rate, immediately boosting demand (positive feedback loop)
- *Intermediate Implementation*
  - Smaller reduction in risk premium
  - Near-term cuts cannot trigger reduction in policy rate
  - For high debt, indeterminacy problem
- (Risk premium not the sole target for fiscal policy)

# Analytical Results in Simplified Model

- Endogenous risk premium reduces determinacy region
- Pro-cyclical spending rule can rule out indeterminacy (needed, steeper is RP and less output-elastic are taxes)
- Spending multiplier negative if RP channel strong enough
- But positive impact of future austerity also enhanced by RP channel

- Expectations-driven liquidity trap (Mertens and Ravn)
- Volatility of risk premium (Fernandez-Villaverde et al)
- Wealth effects of government debt at ZLB (Devereux)
- Feedback from corporate RP to sovereign RP
- Welfare analysis (utility from  $G$ ; heterogeneous population;

- Fiscal adjustment under a peg or in a currency union
- Deflation versus real exchange rate depreciation
- Cross-border spillovers (trade, RP)



- Excellent, insightful paper
- Many unanswered questions