Espino, Kozlowski, Martin and Sánchez (2020): Seigniorage and Sovereign Default: the Response of Emerging Markets to COVID-19

Discussion

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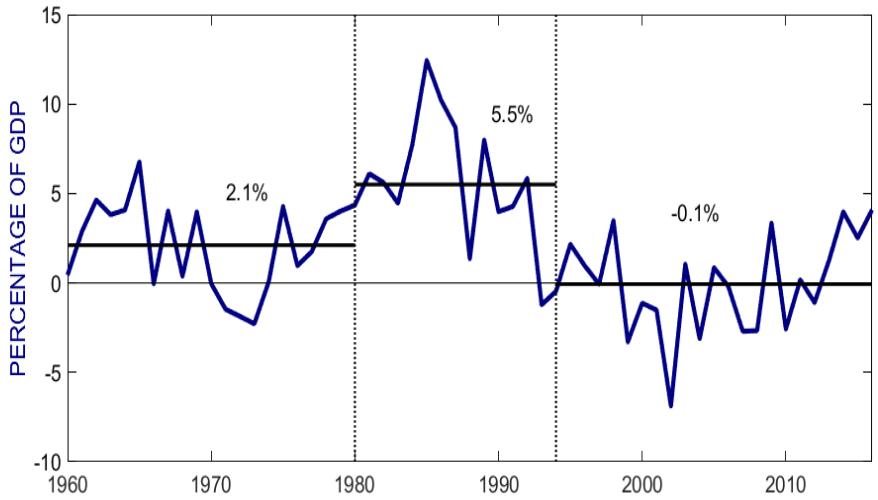
Sovereign Debt Virtual Workshop - FRB Richmond

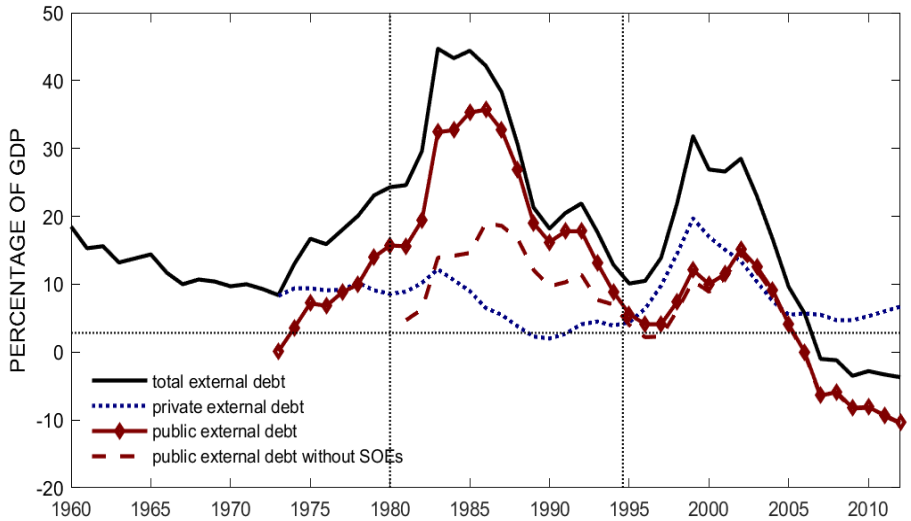
August 25, 2020

Brazil 1960-2016

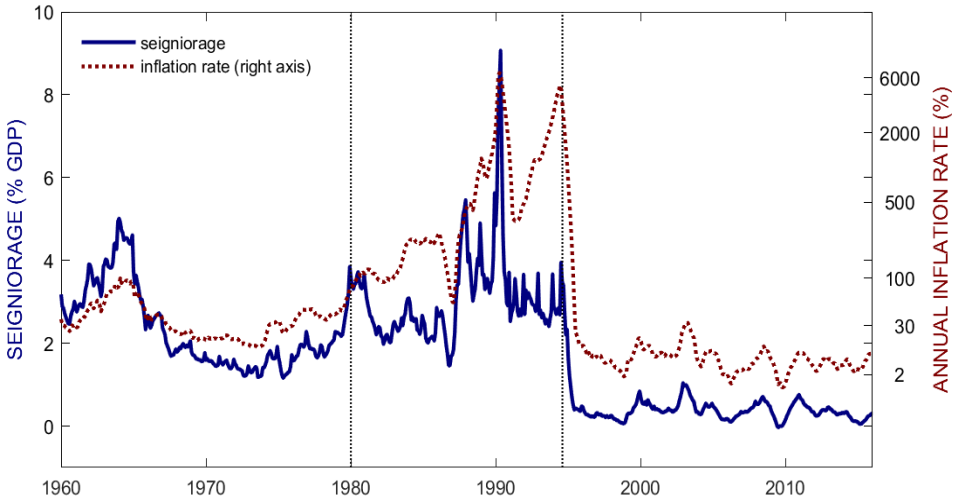
(a) deficit



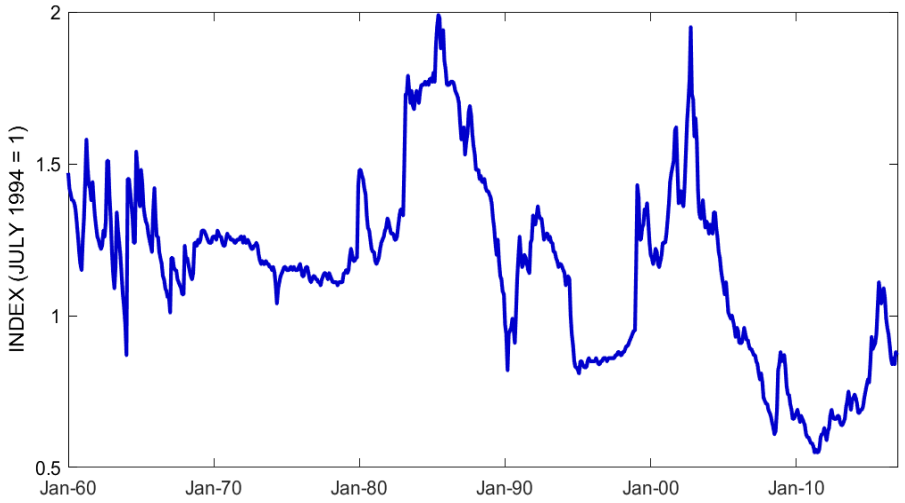
(b) debt/GDP



(c) seigniorage and inflation



(d) real exchange rate



Source: Ayres, Garcia, Guillem and Kehoe (2019)

This paper...

- Latin American EMEs have recurrently relied on seigniorage to finance government expenditure (and debt service)
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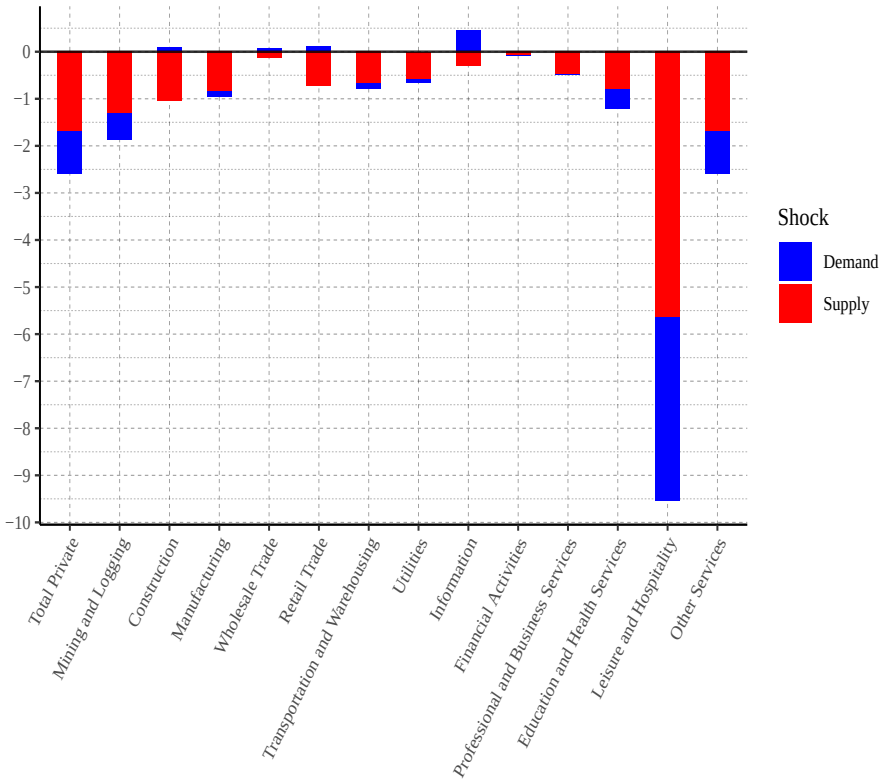
- Time-consistency problem emerges as higher debt in the future leads to more distortions, which affects the current demand for money
- In response to deterioration of ToT, model predicts increase in sovereign risk and inflation coupled with drop in output growth
- Analyze through lenses of model effects of unanticipated COVID shock

Main Comments (1): Sectoral output

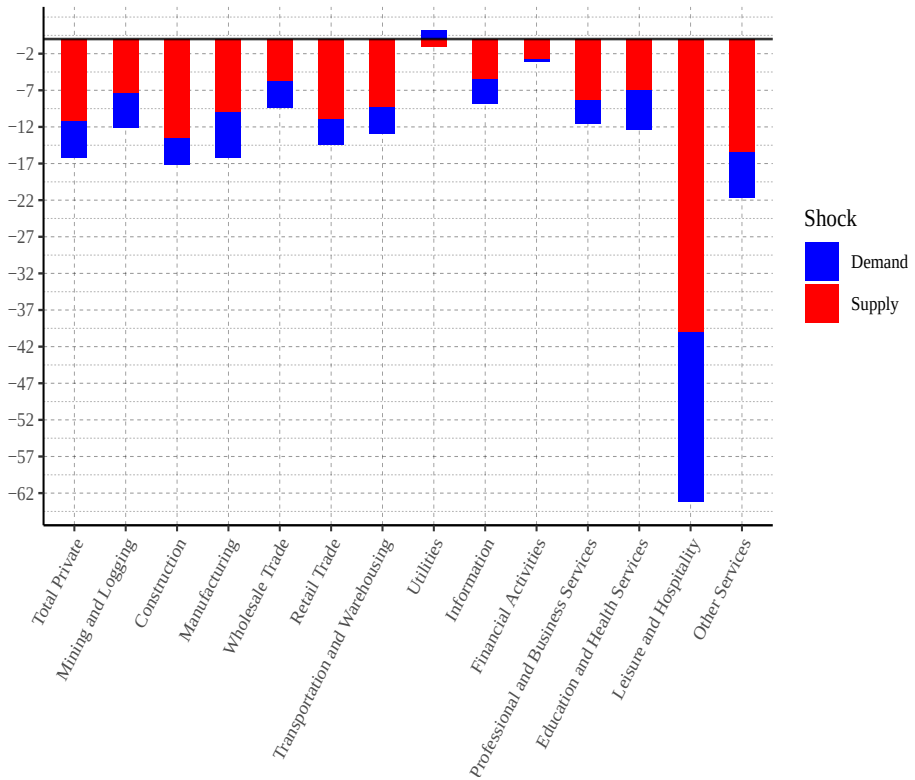
- In the data we observe asymmetric effects of COVID pandemic on sectoral output
  - Overall NT sector hit more severely

Historical decomposition of growth rate of hours by sector

(a) March 2020



(b) April 2020

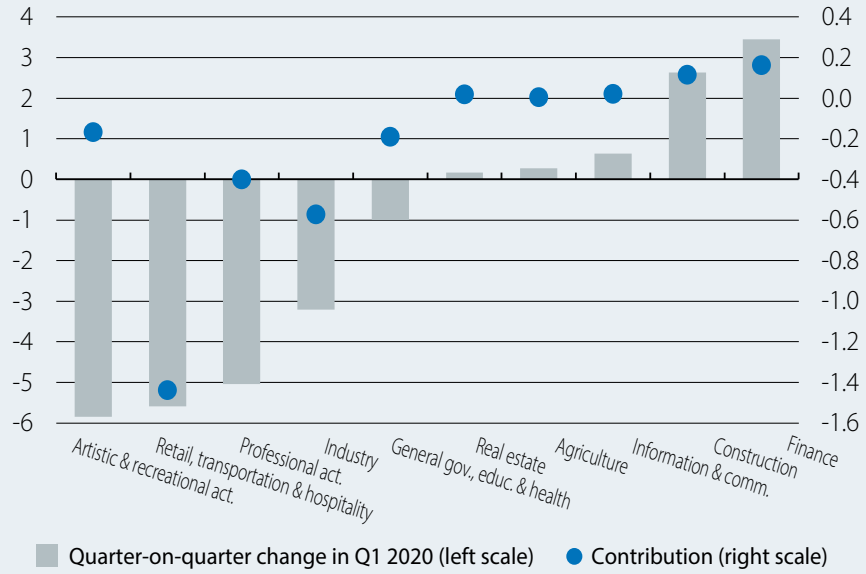


Source: Brinca, Duarte, Faria-e-Castro (2020)

Portugal: GVA growth in Q1 2020

Quarter-on-quarter change(%)

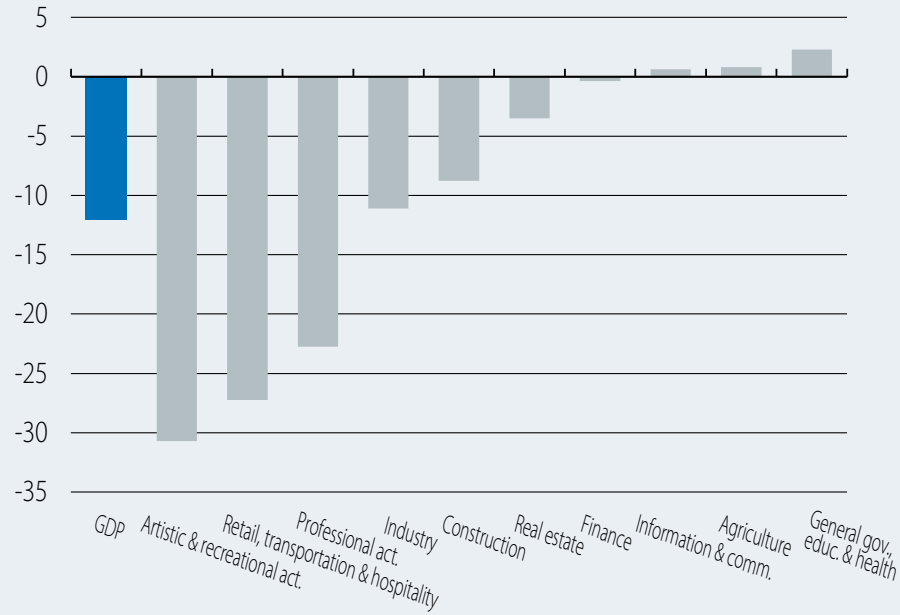
Sectoral contribution to aggregate GVA (pps)



Source: *CaixaBank Research, based on data from Eurostat and the Portuguese Ministry of Labour.*

Portugal: GVA projections by sector in 2020

Annual change (%)



Source: *CaixaBank Research.*

Main Comments (2): RA framework

- Heterogenous effects on households from COVID pandemic
  - workers in certain types of occupations are more economically vulnerable (Mongey, Pilossoph, Weinberg (2020))
  - more likely to experience decline in employment
  - characteristics: less educated, low income, more financially constrained
- Importance of unemployment benefits, transfers, etc. for optimal policy response to COVID
  - missing feature in representative-agent model
  - transfers are exogenous
- Perfect "storm" could also feature a shock to NT preference
  - people avoid consumption through purchases of services

Main Comments (3): Fiscal side

- Role of government consumption
  - no aggregate demand stabilization
  - no room for countercyclical government spending
    - ★ incorporate nominal rigidities (Bianchi, Ottonello, Presno (2020))?
  - model does not capture that higher output raises contagion
    - ★ optimal output may be too high in model
    - ★ disutility from health concerns gives rise to externality (Guerrieri, Lorenzoni, Straub, Werning (2020))
    - ★ key feature for policy analysis
  - more parsimonious alternative: exogenous g^N

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- Of-the-book government transfers in Latin American EMEs
  - due to nationalization of banking sector, subsidies through state-owned companies/development banks
  - largely covered with seignoriage (Kehoe, Nicolini (2020))

Other Comments

- Quantitative performance of model in pre-COVID times
  - report second moments (relative volatilities, correlations)
  - consistent with data for EMEs?
- Control for degree of central bank independence
  - has been evolving over time for some EMEs (Garriga (2016))
  - fiscal and monetary authority are consolidated in the model

Concluding remarks

- Role of seigniorage quite overlooked in sovereign default literature
- Interesting paper on very current and relevant topic

Thank you!