Discussion of Life-cycle forces make monetary policy transmission wealth-centric Paul Beaudry, Paolo Cavallino, and Tim Willems

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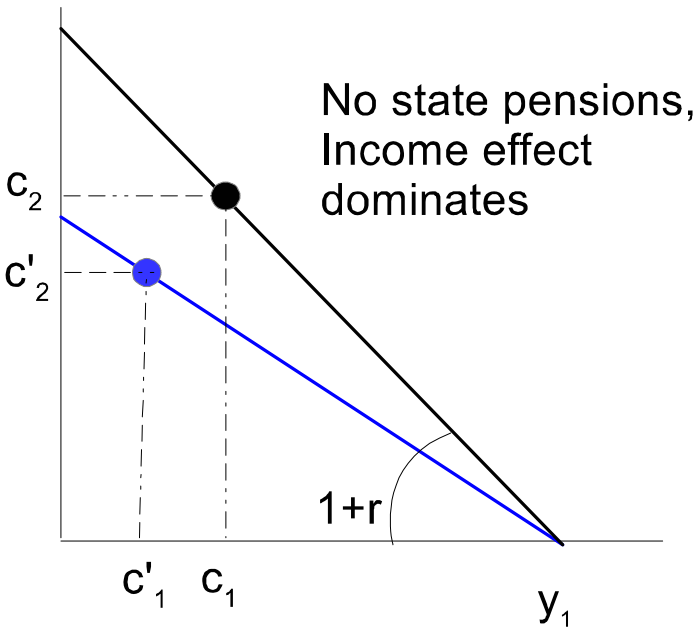
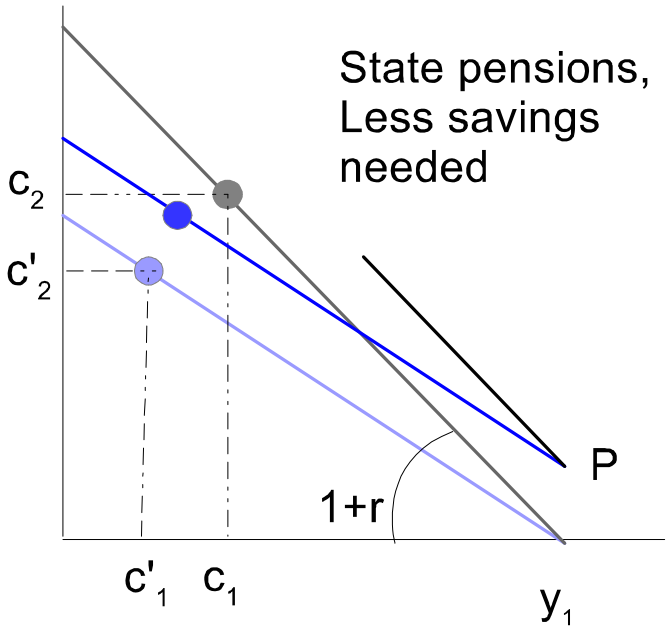
Discussion



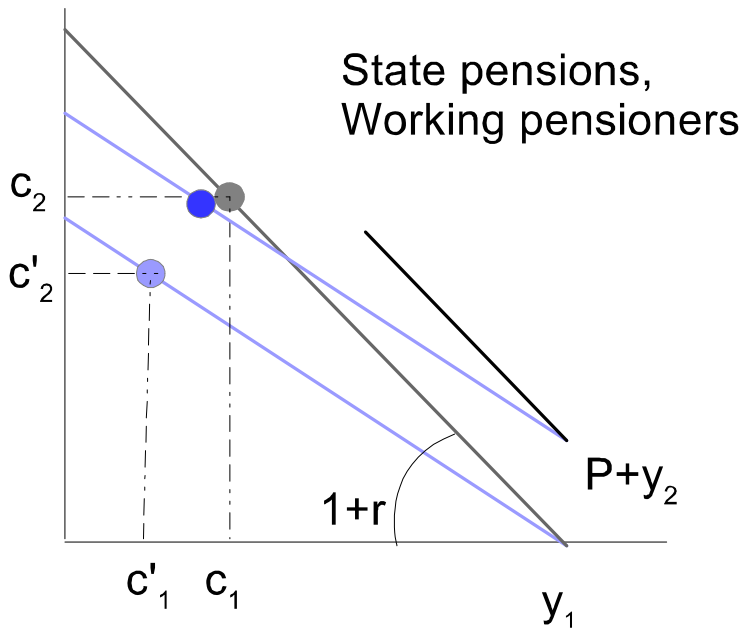
- The BCW models the mechanism, which – due to the presence of savers – results in a dominating *income effect*.
- Consider real interest rate reduction in a two-period model with no second-period income (no state pension).
- Income effect may dominate and consumption in the first period falls.

Discussion



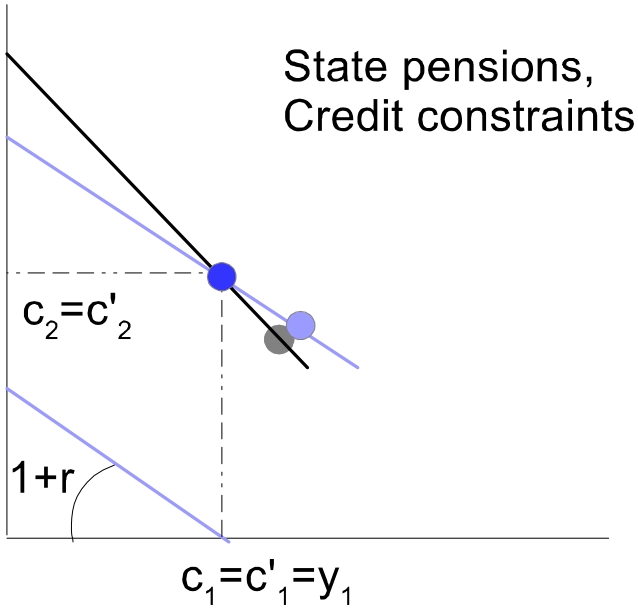
- Some features that are likely to affect the mechanism.
  - With state pensions the effect is likely to be smaller.

Discussion



- Some features that are likely to affect the mechanism.
  - Working pensioners. Planning and Preparing for Later Life: DWP survey 2020/21:
    Most people (62%) who had not yet retired expected to continue in paid work beyond their ideal retirement age.

Discussion



- Some features that are likely to affect the mechanism.
  - Credit constraints.
    There is no effect of interest rates on consumption.
    Wealth and Assets Survey, 2018-2020:
    Almost a third of people did not expect to have any pension provision beyond the State Pension when they retired.
    FCA statistics:
    Up to a third (34%) of UK adults had either no savings, or less than £1,000 in a savings account.

Discussion

- The income effect in the BCW paper is due to large asset holdings by the retired.
- We need a heterogeneous agents model to analyse these effects

Discussion

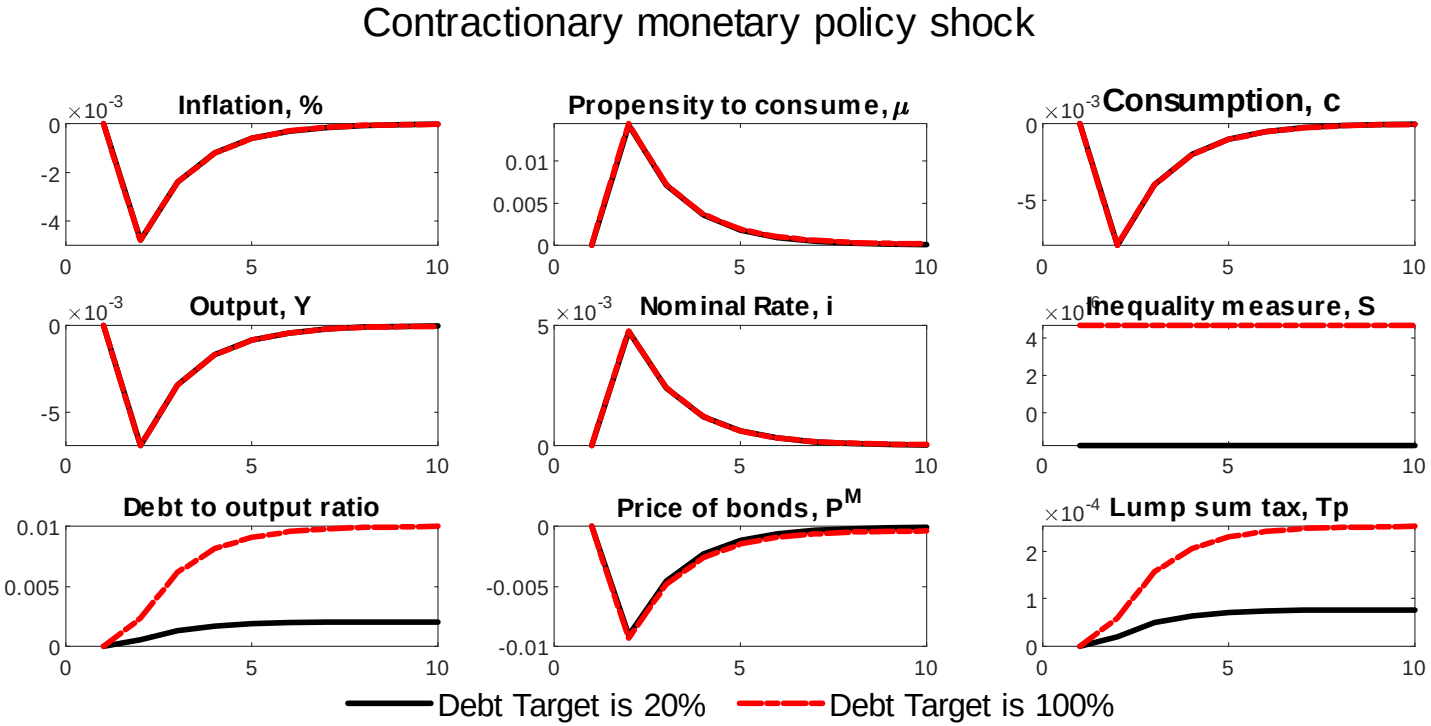
- Consider BY model with declining labour income (KKL: Karaferis, Kirsanova and Leith (2024))

$$c_t = -\frac{1}{\sigma}\log\left(\beta R_t\right) + c_{t+1} + \frac{\delta}{1-\delta}\mu_{t+1}R_t P_t^M b_{t+1}^L - \varkappa\mu_{t+1}\varphi_{t+1}$$

$$\frac{1}{\mu_t} = \frac{1-\delta}{R_t\mu_{t+1}} + \left(1 + \psi\sigma\left(1-\tau_t\right)w_t\right)$$

- μ_t is the *marginal propensity to consume* $\sim$ consumption/resources and we are always on the 'lower' arm of the C-curve, as $1 - \frac{\vartheta}{R\uparrow} = A\mu\uparrow$
- $\frac{(1-\vartheta)}{\vartheta}\mu_{t+1}R_t P_t^M b_{t+1}^L$ is an income effect

Discussion


Contractionary monetary policy shock
Inflation, %
Propensity to consume, μ
Consumption, c
Output, Y
Nominal Rate, i
Inequality measure, S
Debt to output ratio
Price of bonds, P^M
Lump sum tax, Tp
Debt Target is 20%
Debt Target is 100%

Discussion

- No noticeable effect! Why this may happen?
- Optimal level of debt in BCW ($R = \frac{1}{\beta}$), both sides of optimality in KKL.
- All assets are owned by the working population in the BCW vs Most assets are owned by the older generations ('retired') in KKL. But inequality increases (S-panel)
- Large amount of assets, *all held by the young*, is likely to be responsible for the large income effect.

Discussion

- Jointly optimal policy with lump-sum taxes generates the optimal level of debt in KKL, as rightly assumed in BCW.
- However, jointly optimal policy with distortionary labour taxes will keep debt lower ($R < \frac{1}{\beta}$), with insufficient savings for retirement.
- Equity vs. Efficiency
  - Taxes needed to service the debt create an efficiency-reducing distortion in the economy
  - $B_{eff} << B_{opt} < B_{ineq} < B_{GR}$
  - Lower interest rates help households to smooth consumption in case of idiosyncratic shocks.
- Monetary policy should not neglect distributional aspects.