SciencesPo

ECB Monetary Policy conference

Discussion of Paul De Grauwe and Yuemei Li's Paper

Natacha Valla (Sciences Po)

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Online Event

A paper with an original angle

- Trust as factor in transmission of (negative) S&D shocks
- 2-tiers trust: in policymaker and in the strength of the economy
- Good and bad outcomes possibles (bimodality) as a response to negative shocks
- No endogeneity of trust, but asymetry in relation between outcomes and the dynamics of trust
- Initial conditions matter → no unicity, path dependency – no need to worry about « stability of equilibrium/steady state » in this framework
- Calibrated model – but that is fine as it is helpful to derive stylised interpretations of outcomes

Epistemological question on behavioural models for policy

- How does it compare to outcomes from
  - Adaptive learning (akin to « cognitive limitations » in the papers' assumptions)
  - Rational learning (message of caution for policy action – Brainard uncertainty)

- How can it account for strategic interactions?

On bimodal distribution of IRFs

- Non Gaussian IRFs

- Bimodal responses of output gaps and inflation

- How does it compare with literature that provides evidence on model-based output-gap estimations (eg Proietti et al.)? Could a behavioural model provide an explanation for such observations from statistical models?

On trust (in institutions / in the future)

- What is trust?
  - ~ credibility? i.e. belief that CB will deliver on inflation
  - ~ optimism, confidence? i.e. that growth will be strong in the future
- Could the one strengthen the other?
  - Why treat them as independent?
  - Back to the question of strategic interaction

Which relationship with the optimal policy literature?

- Temptation to read the paper in light of the optimal monetary policy response literature!

- Specific colour of oil-driven supply shocks and inflationary developments

- As early as Gordon, Blender, Turnovski, etc

- Transparency/Communication: optimal response to cost-push shock depends on disclosure / impact of communication (Baeriswil and Cornand (IJCB 2010)) / both signs possible ➔ can this be interpreted as « trust »?

- Quid of relative prices?Michael Plante (Dallas Fed 2014): the relative price of oil matters for the effectiveness of the policy response to supply shocks

Initial conditions matter: rings a bell

- Economic rationale?

- Resembles temporary supply shocks with demand inertia
  - Caballero and Simsek (2022): when initial demand is low, worth overheating the economy
  - Inertia in trust?