Heterogeneity and Monetary and Fiscal Policy in the Pandemic

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Heterogeneity in Macroeconomics: Implications for Policy

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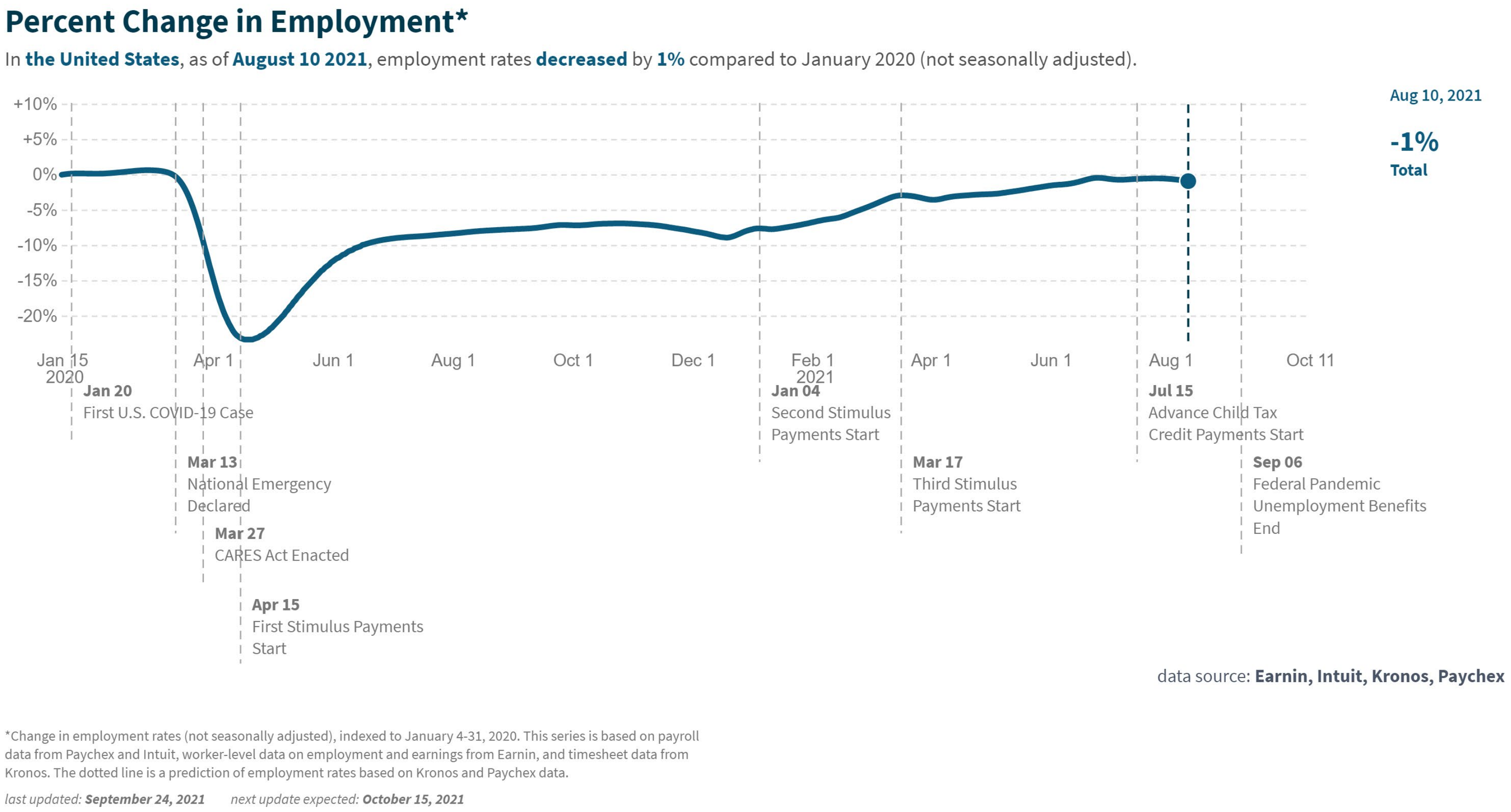
Heterogeneity and Policy

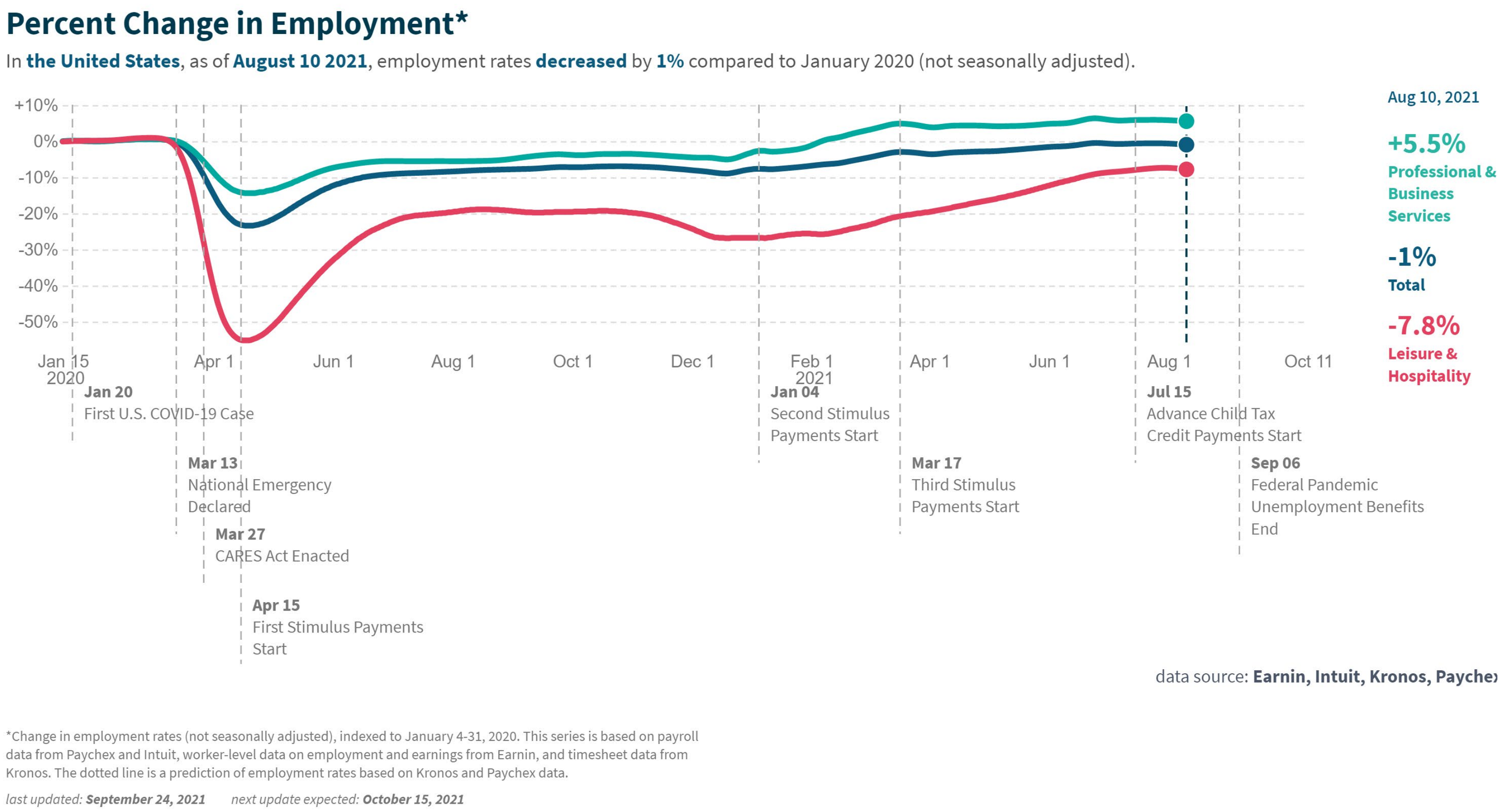
- Growing interest from policy makers in embedding heterogeneity in the macro models they use
- How is heterogeneity important to understand the macro impact of the pandemic and the effectiveness of different policy responses?
- Two types of heterogeneity are key to think about the pandemic: agents' balance sheets heterogeneity and sectoral heterogeneity
- In particular, I will address three key elements of the policy debate:
    1. Aggregate demand and supply effects of the pandemic
    2. Fiscal transfers
    3. Inflation

Employment - US



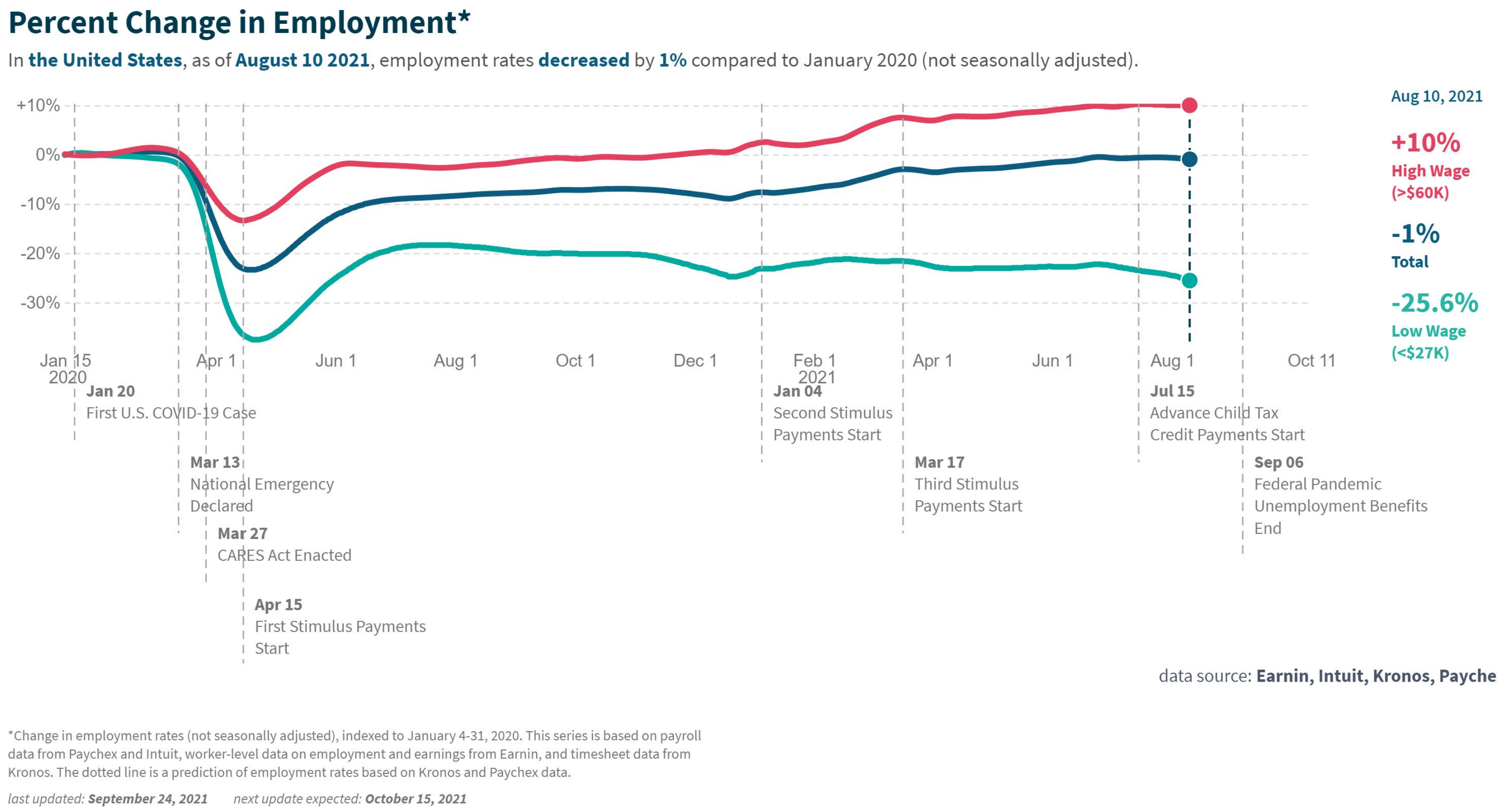
Source: Opportunity Insights – Economic Tracker

Employment By Sector - US



Source: Opportunity Insights – Economic Tracker

Employment By Income - US



Source: Opportunity Insights – Economic Tracker

Aggregate Effects of Covid-19

Guerrieri, Lorenzoni, Straub, Werning (2021a)

- Covid-19 hit more severely sectors/sub-sectors and segments of the labor market that involve more personal interaction

- One can think of it as a negative supply shock in those sectors (containment policies, workers fear, consumers fear)

- However, it propagated to the whole economy through demand channels:

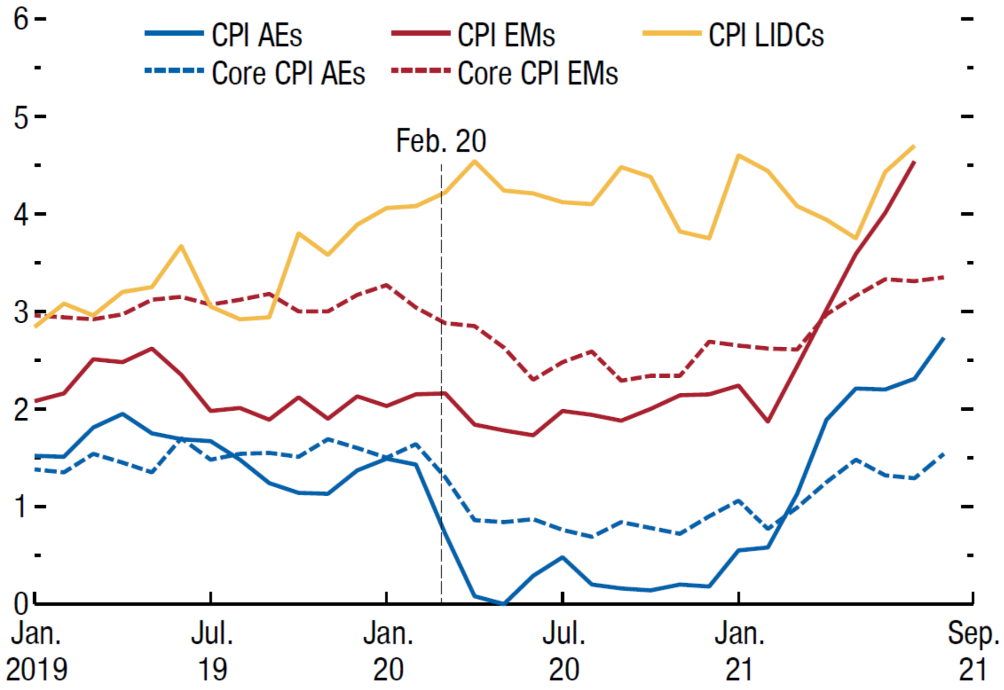
1. Key role of agents heterogeneity: income losses of workers with high MPC mean aggregate demand shortages

2. Additional role of sectors complementarities and supply chains: disruptions in some sectors may propagate to others

Implications for policy

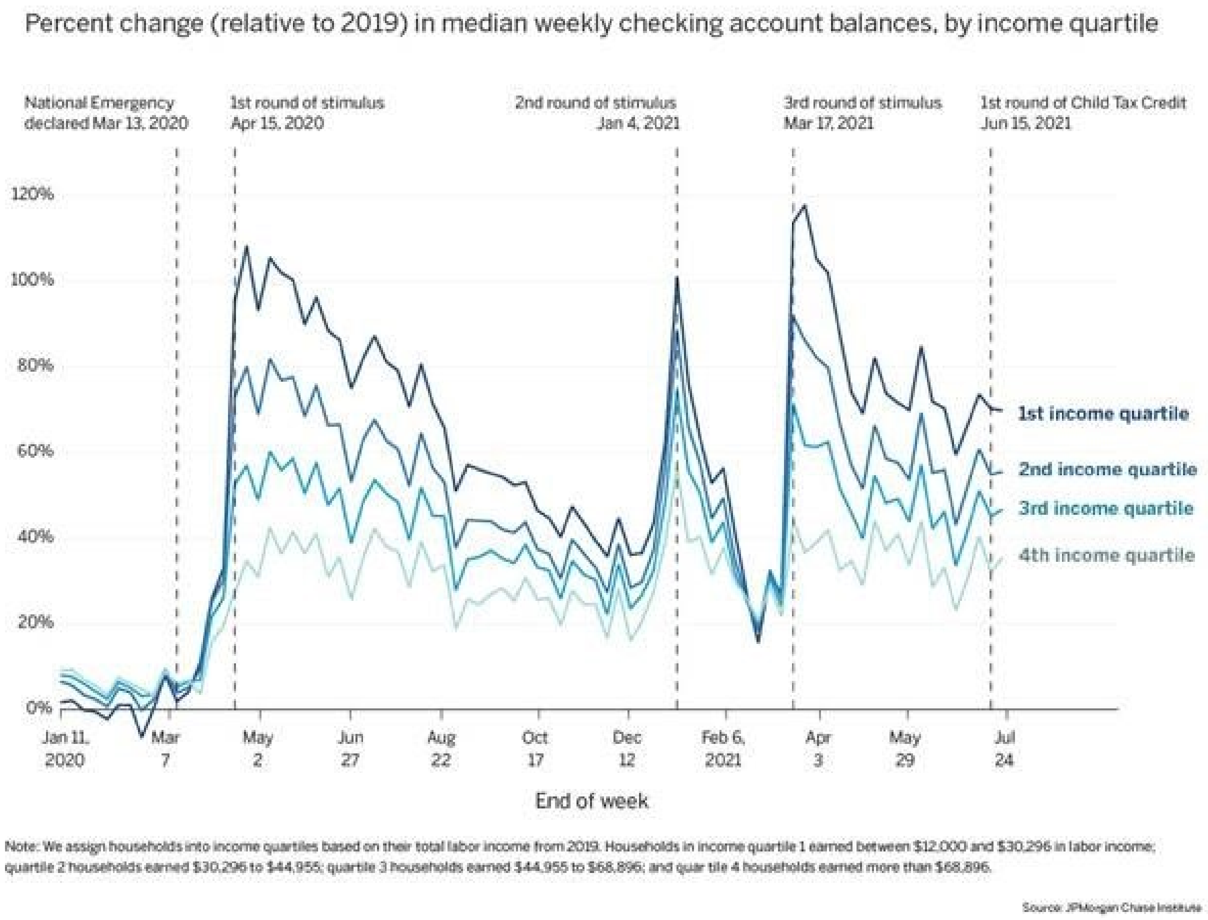
- Demand shortages coming from both income effects and sectoral spillovers calls for **stimulus**
- However, the asymmetric nature of the shock also calls for **social insurance**
- **Targeted fiscal transfers** can achieve both objective (while government spending or conventional monetary policy only the first)
- In the presence of health shocks, there is also a desirable complementarity between transfers and containment policies as transfers reduce their costs
- Fiscal stimulus has been massive in the US
- The literature on HANK models has helped better understanding not only the impact effects of transfers but also to trace out their dynamic effects (from Oh and Reis on)

Inflation: Was fiscal stimulus too aggressive?

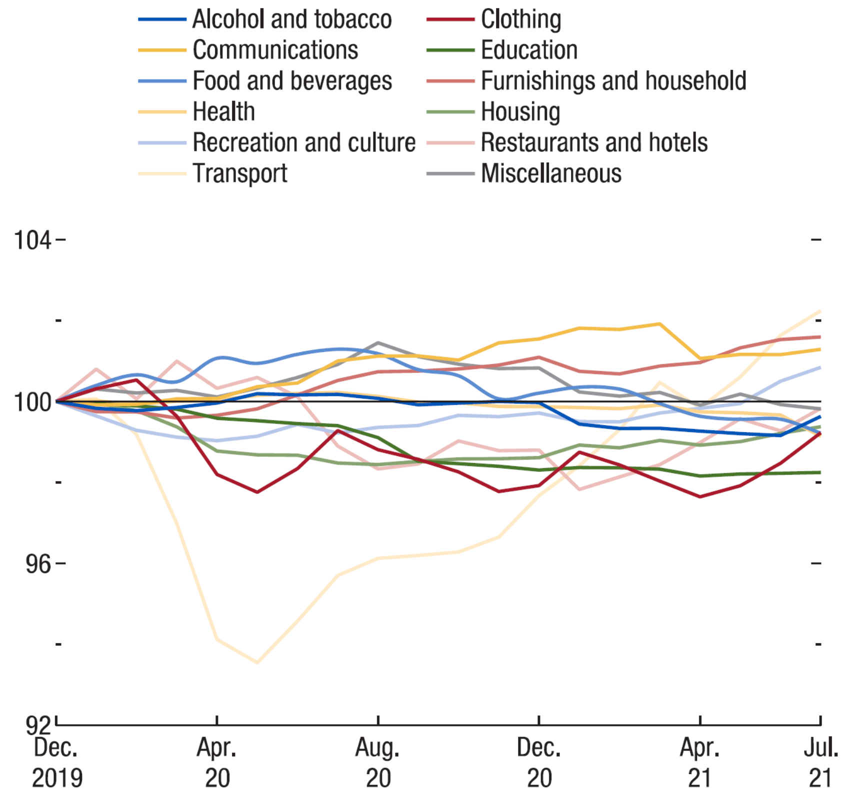


Sources: Haver Analytics; IMF, CPI database; and IMF staff calculations.
Note: The vertical line indicates February 2020. AEs = advanced economies; CPI = consumer price index; EMs = emerging market economies; LIDCs = low-income developing countries.

Heterogeneous response to stimulus



Price Movements By Sector - US

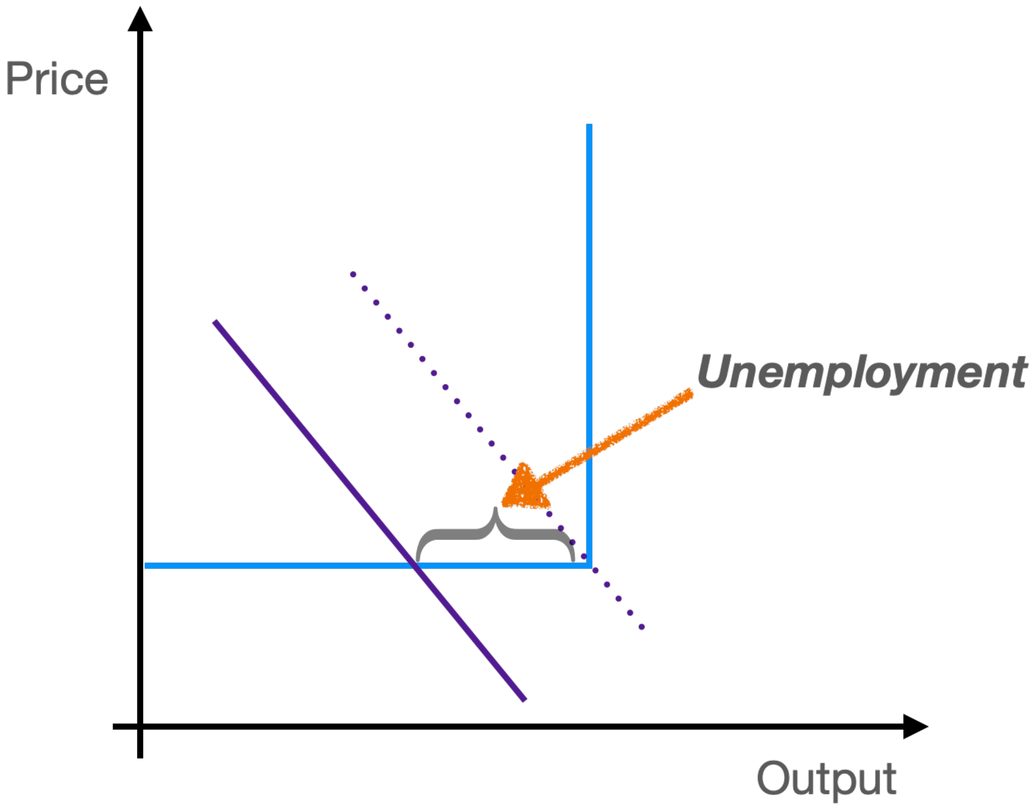


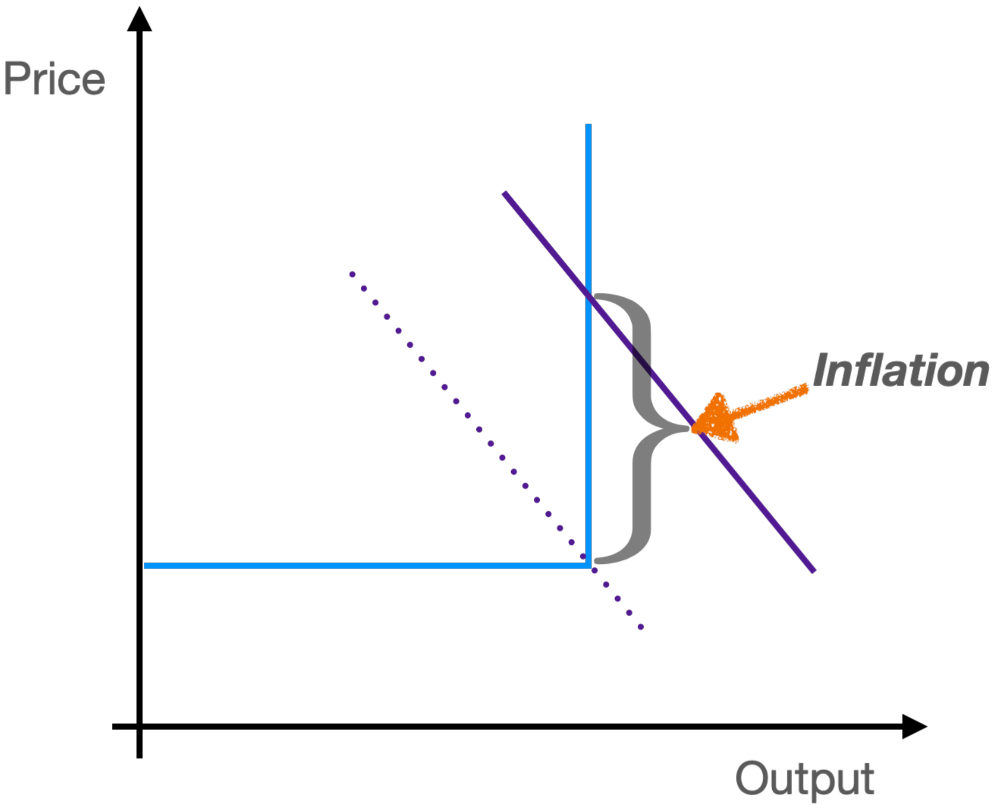
Sources: IMF, CPI database; and IMF staff calculations.
Note: The lines are averages weighted by country's purchasing-power-parity GDP.

Source: World Economic Outlook - IMF

An Uneven Shock – 2 Sectors

Guerrieri, Lorenzoni, Straub, Werning (2021b)

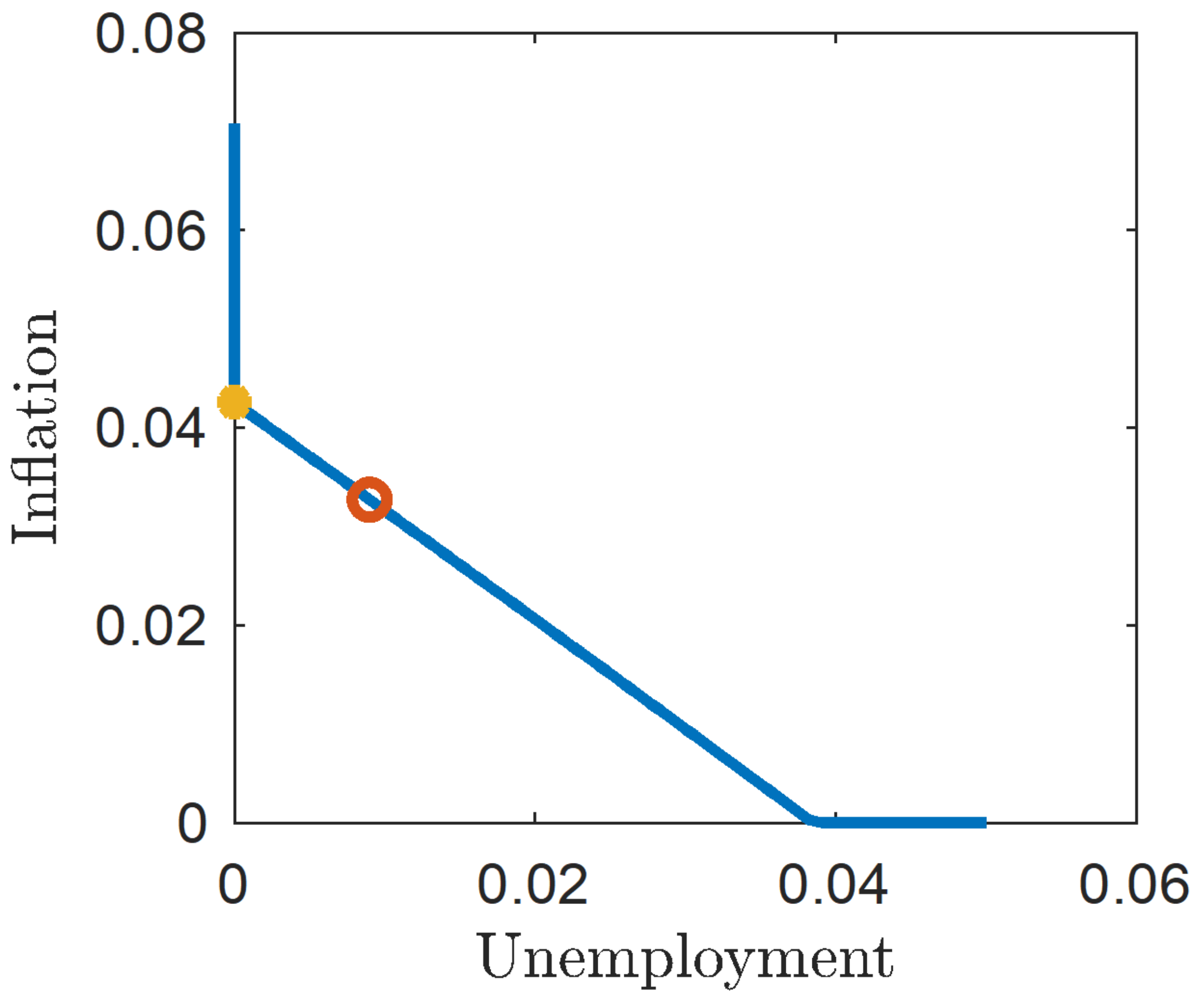




Sector A

Sector B

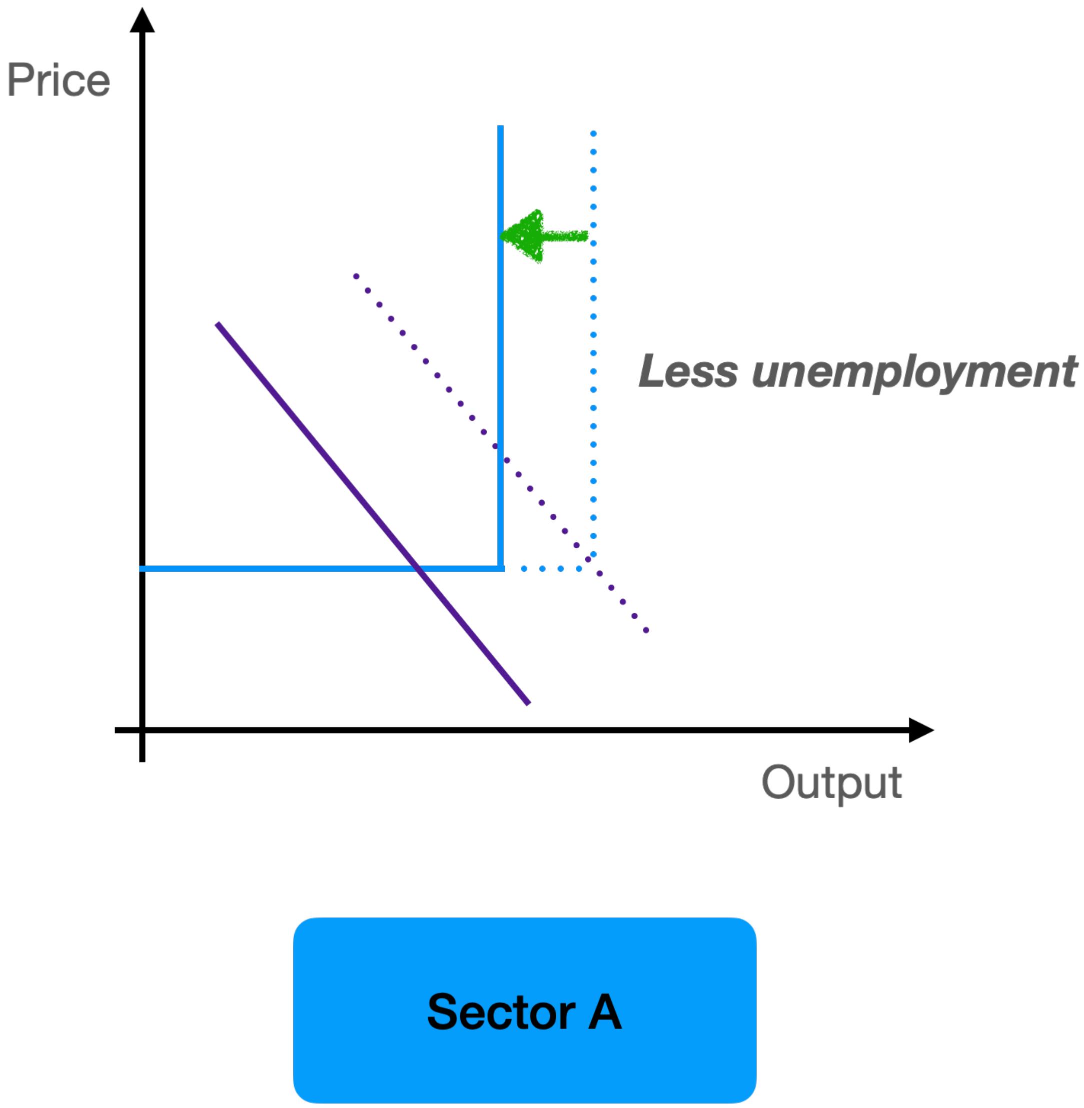
Phillips Curve

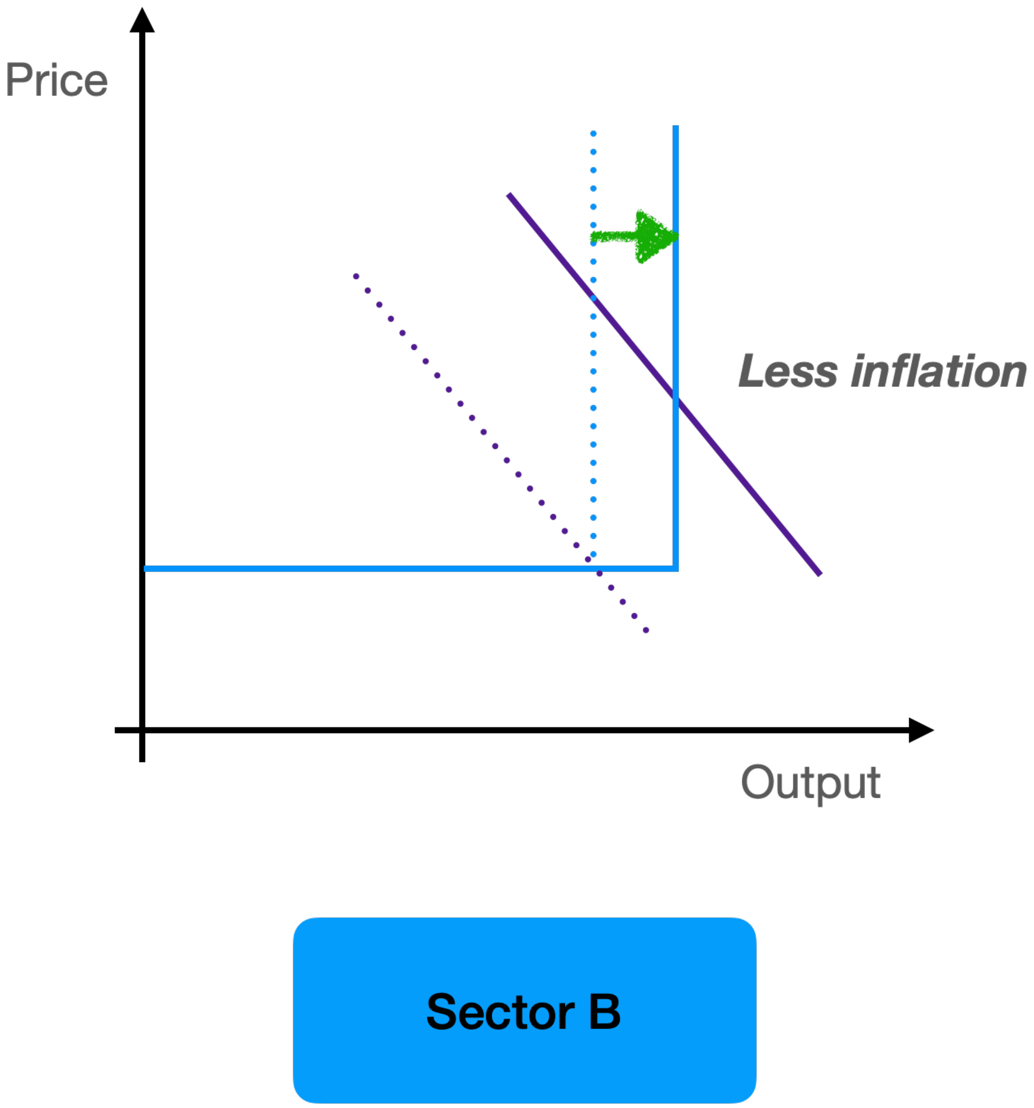


Is the Pandemic a Permanent Shock?

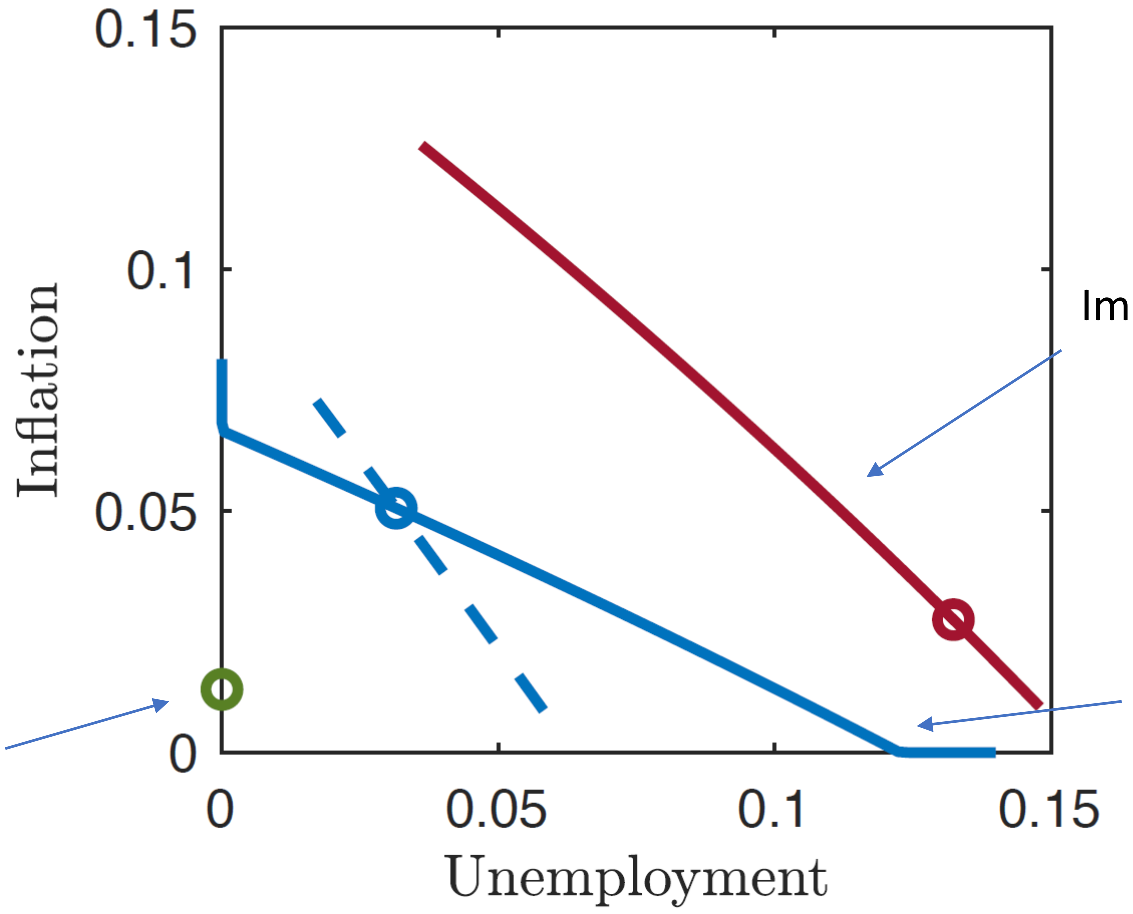
- Barrero and Bloom (2020) argue that the pandemic is going to have long-lasting effects on the economic structure
- Labor reallocation needed towards sectors that will succeed in the long run
- Common view: we should even more worried about the Central Bank to run a hot economy
- Guerrieri, Lorenzoni, Straub, and Werning (2021): allowing for more inflation in booming sectors may actually increase wages and attract more labor
- Especially in a world where wages are mostly downward-rigid

Labor Reallocation





Phillips Curve



Immobile labor

With labor reallocation

Central Bank can do better with mobility subsidies

Final Remarks

- HANK models key to understand the role of income spillovers in the pandemic and the static and dynamic effects of transfers in response to that

- To think about the pandemic, it is important to bring into the picture also another form of heterogeneity: across sectors or labor market segments

- Once policy support is strong enough, asymmetries across sectors create difficult policy dilemmas