Discussion

“Dispelling the Shadow of Fiscal Dominance? Fiscal and Monetary Announcement Effects for Euro Area Sovereign Spreads in the Corona Pandemic”

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Monetary vs. fiscal: who pulled the euro area through the pandemic?

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Overview

Question:

What is the relative importance of fiscal and monetary policy for euro area government bond spreads?

Approach:

Event study regressions comparing monetary and fiscal pandemic measures

Main findings:

PEPP has been highly effective, fiscal rescue announcements less so

Policy conclusion:

"Looming fiscal dominance": Danger that ECB is only player that can stabilize sovereign debt markets

Comment # 1: Sovereign spreads

Spread measure: yield of 10-year government bonds relative to German bund yields

- Might want to look at shorter (3 or 5 year) maturities

  → average maturity of Euro Area debt closer to 5 years (Corradin et al., 2021)

  → shorter maturity yields tend to be more reactive (Bahaj, 2020)

- Why not also consider sovereign credit default swap spreads (CDS)?

  → provides sensible robustness check

  → would allow you to include Germany in the analysis

Bond spread combination of different latent components (Krishnamurthy et al., 2018)

- default risk, redenomination risk, liquidity risk, . . .

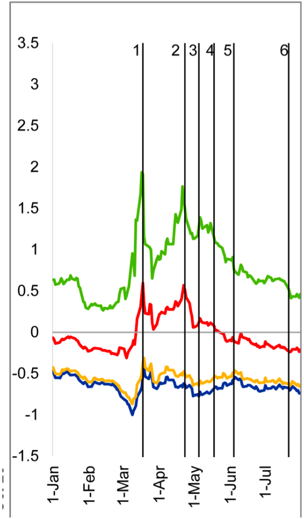
  → policies might have different effects depending on dominating channel

Comment # 2: Difficulty of timing fiscal events

Fiscal policy	Relaxation of EU fiscal rules	13.03.2020	European Commission makes first announcement that it considers the activation of the SGP escape clause
		20.03.2020	Formal proposal by European Commission to activate SGP escape clause
	EU fiscal corona packages	13.03.2020	Mobilization of EU budget flexibility to increase cohesion spending
		01.04.2020	Proposal of SURE (Support to mitigate Unemployment Risks in an Emergency)
		09.04.2020	Agreement by EU finance ministers on 540 billion package including SURE, EIB and ESM
		18.05.2020	French-German proposal that paved the way towards Next Generation
		27.05.2020	European Commission Proposal of Next Generation EU with various surprises compared to German-French model
		21.07.2020	Political agreement on Next Generation EU in the European Council

Comment # 2: Difficulty of timing fiscal events

Five-year bond yields



- Figure on the left from Corradin et al. (2021) who tackle a very similar question (should be cited)
- April 23, 2020, (line 2 on the right): EU leaders agree to work towards establishing a recovery fund

  → not used in the paper here

  → seems to produce strong market reaction
- Which events to include and which not?

  → easier with regard to ECB announcements
- How surprising are these events really if discussed over months (at least April to July)

  → Is there any survey or betting-market evidence?

Comment # 3: Policy conclusions

- Results here (and in other papers) point toward monetary policy being more successful in stabilizing sovereign bond markets than the announced fiscal measures
- Useful to see that grant-based fiscal measures more effective than loan-based measures → probably confirms most peoples' prior
- But should we fear a "looming fiscal dominance of the ECB in the presence of rising public debt levels"?

  → Not so fast!
- Asset purchase programmes by now known entities with little uncertainty, central banks have honed their communication skills
- EU-wide fiscal programmes completely different animal, decision processes much more muddled and details/outcomes more uncertain

  → we are not doomed but should improve the fiscal side of things

To sum up

- Very interesting, topical, and policy relevant paper
- A lot of food for thought on how fiscal policy can pull its share in tackling the next crisis

References I

Bahaj, Saleem (2020). "Sovereign spreads in the euro area: cross border transmission and macroeconomic implications". *Journal of Monetary Economics 110*, 116–135.

Corradin, Stefano, Niklas Grimm, and Bernd Schwaab (2021). "Euro area sovereign bond risk premia during the Covid-19 pandemic". ECB Working Paper 2561.

Krishnamurthy, Arvind, Stefan Nagel, and Annette Vissing-Jorgensen (2018). "ECB policies involving government bond purchases: impact and channels". *Review of Finance 22* (1), 1–44.