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?
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**

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