

**Discussion of**  
**“Fiscal Populism and Monetary Policy Rules”**  
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# Overview

- Data: annual panel ( $\approx 50$  countries, 1960-2008) + IT qtrly panel (32 countries, IT-2023)
- Results:
  1. left-wing populists  $\rightarrow$  persistent rise in central-bank credit (monetization)  $\rightarrow$  higher inflation (right-wing: insignificant)
  2. IT central banks with this past respond *more* to the expected-inflation gap, beyond past inflation; more so when disagreement is high or inflation accelerates

## $\Rightarrow$ Shadow of populism

- central-bank independence in these countries cannot be taken for granted
- IT countries are not homogeneous: populist/fiscal history shape the rule

# Position in the Literature

- Three big literatures:
  - experience-based learning and inflation expectations → a history of inflation has persistent effects on individuals' expectations (Malmendier & Nagel)
  - fiscal dominance & inflation – but IT central banks usually treated as homogeneous group
  - political economy of monetary stabilization policy
- New link: how monetary policy responds when public's expectations carry that political economy history
  - ⇒ Timely work that speaks to how aggressively central banks must respond to shocks when a populist past looms

# Discussion

1. Core empirical results
2. Understanding the mechanism
3. Assessing the success of a more hawkish policy

## Assessing the core empirical results

## Result 1: Left-wing Populism → CB Lending → Inflation

- Compelling chain **but** does it operate only via discretionary deficit monetization?
  - **Crises** often help populists gain power
  - A surge in CB credit might reflect **fiscalized financial stability support** → core CB role
  - Financial crises raise CB credit *and* are independently inflationary in EMDEs
    - Macro effects are highly persistent, CB balance sheets and fiscalized financing can remain abnormal for years
    - Replacing CBL growth with the *abnormal episode* dummy further isolates extreme spikes that may be disproportionately crisis-related
- ⇒ The credit-inflation correlation may partly reflect **crisis rescue monetization**, rather than just discretionary monetization pass-through
- ⇒ Upper bound on the discretionary deficit monetization channel

## Result 2: Left-wing Populist Past → Stronger Reaction Coeff Today

- Striking result: a left-wing populist past → larger  $\phi_{\pi}$ , even controlling for past inflation
- **Interesting:** When all past variables are included, past central-bank lending loses its independent effect, while left-wing populism and past inflation remain significant
  - the legacy effect operates through left-wing populism **more broadly**, not just isolated to the monetization→inflation mechanism - may be valuable to unpack
- Regressions do not tell us **why** these CBs are responding more aggressively to the inflation expectations gap

## Understanding the mechanisms behind Result 2

## Understanding the Mechanism Behind Result 2

**Why is there a stronger reaction coefficient on the inflation expectations gap?**

(1) **Mechanical stabilization mechanism (what the model develops) ?**

- expectations are less anchored because of experienced past inflation
- larger rate hikes are required to keep inflation at target

(2) **Credibility / signaling interpretation?**

- CB has to signal independence and commitment to price stability more strongly given this past, so they react more aggressively when  $\pi^e$  moves above target
- But: backward-looking experienced learning and reputation-building **should fade**
  - memory recedes, credibility is earned → the coefficient should converge back
- **However: do not find a statistically significant decay in the response coeff – for now?**

## Understanding the Mechanism Behind Result 2

### (3) Institutional reform?

- past populism leads to redesign towards a more hawkish CB
- consistent with evidence of higher measure of CB independence in these countries
- **However: find larger coefficient when private sector  $\pi^e$  dispersion is higher**
- Goes against a fixed Rogoff conservative preference, which would be a constant
- CB is not expressing a taste; it is responding to a second moment of the environment → suggests fragility of inflation expectations and CB independence

### (4) Current “EMDE” or “general macro stress”?

- legacy dummy absorbing current state
- nonlinear policy rule + prevalence of large shocks
- **However: left/right populism asymmetry  $\Rightarrow$  *not* generic EM volatility ; suggests fragility *through* the populist history**

## Understanding the Mechanism Behind Result 2

### (5) **Forward-looking regime-switching probability effect? (my preferred interp.)**

- currently monetary-led regime, but agents put positive proba on a switch to fiscal dominance and that belief raises the  $\phi_\pi$  needed today
- Bianchi–Melosi (2017, 2019): the *shadow* of potential fiscal dominance de-anchors expectations
- consistent with evidence of monetized past, state dependence, no decay

## A larger $\phi_\pi$ : three rational expectations options

1. Full RE, known regime, credible monetary dominance - *ruled out*
  - passive fiscal authority, debt stabilized  $\Rightarrow$  expectations anchored
  - Taylor principle suffices; strong reaction *not needed*
2. RE signaling: uncertainty about CB *type* - *possible*
  - agents unsure of the bank's hawkishness / independence
  - update beliefs from the policy action
  - strong rate response *reveals type* (still RE, incomplete info)
3. RE + uncertainty over the future fiscal regime - *possible*
  - agents rational, but price a positive prob. of future fiscal dominance
  - today's  $\pi_t^e$  already reflects that probability
  - CB responds to a more fragile expectations process

$\phi_\pi$  alone doesn't tell apart 2 vs 3

## Separating models empirically: event studies around news

- The same reduced-form  $\phi_\pi$  is consistent with (a) backward-looking experienced learning model, (b) credibility building under RE + imperfect info on CB type, and (c) RE + forward-looking regime switching model; past populism affects RE agents' priors
- Cleanest test: condition on the *type* of news moving expectations
  1. Realized-inflation surprises
    - do long-horizon expectations track realized inflation?
      - ⇒ supports backward-looking, extrapolative expectations
  2. Contractionary monetary-policy surprises
    - do they compress long-horizon expectations + dispersion on impact?
      - ⇒ supports signaling / credibility
  3. Fiscal-news shocks
    - do expectations move a lot after fiscal news specifically (debt/deficit revisions)?
      - ⇒ supports regime-switching / fiscal-dominance risk

## Assessing the success of a more hawkish policy

# Does the Steeper Rule Anchor Expectations?

- The headline regression is a *reaction function*
    - tells us the CB **works harder** but does that work **pay off**?
  - Consider complementing results with an **outcome regression**:
  - Keep the **predetermined legacy** on the RHS
  - Flip the LHS to an **anchoring measure**
    - sensitivity of long-horizon  $\pi^e$  to short-run inflation surprises  
(*anchored  $\Rightarrow$  long-horizon  $\pi^e$  does not move with realized inflation*)
    - $\pi^e$  dispersion; persistence of  $\pi^e$  gaps; inflation-gap volatility
- $\Rightarrow$  Anchoring comparable to clean-history countries = **strength**
- $\Rightarrow$  Still worse anchored despite the steeper rule = **symptom** of fragility

# Conclusion

- Important, timely paper: brings together experienced learning and fiscal-dominance, shows IT central banks are *not* homogeneous: the populist/fiscal past shapes the rule
- A larger  $\phi_\pi$  is reduced-form: it tells us **how much**, not **why**
  - same coefficient is consistent with experienced learning (the model), CB type signaling, and forward-looking regime risk
- To separate channels: condition on the *type* of news moving expectations
  - realized inflation  $\rightarrow$  experienced learning; MP surprises  $\rightarrow$  signaling; fiscal news  $\rightarrow$  regime risk
- The open question given this past: effective policy or costly chronic symptom of fragile expectations?

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