

Discussion of: Policy Mix in a Small Open Emerging Economy with Commodity Prices

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A semi-structural Model for Mexico

Key features

- Government collects income from oil exports
 - Oil price (exogenous) and exchange rate (endogenous) affect fiscal stance
- Public debt have both domestic and foreign components
 - The shares of domestic and foreign debt are (somewhat) exogenous
 - The cost of servicing debt includes a risk-premium, depending on the primary balance
 - The risk-premium affects the exchange rate through an UIP condition
- Augmented IS and Phillips curves
 - Affected by exchange rate (both) and risk-premium (the IS)
- Standard Taylor rule for monetary policy
- Fiscal rule for the central government
- Each equation has its own shock (plenty of them)

Relation between Fiscal and Monetary Policy

An increase in government expenditures

- Increases debt and the risk premium
- Depreciates the exchange rate
- Increases output gap and inflation
- Leads to a contractionary monetary response

An increase in the nominal interest rates

- Appreciates the exchange rate
- Reduces output gap and inflation
- Lower tax collection and increases government borrowing costs
- Forces the government to cut spending to satisfy fiscal rule on debt

Relation between Fiscal and Monetary Policy

Other shocks (oil, risk premium) require a coordinated response by fiscal and monetary authorities

For instance, an increase in the risk premium

- Increases the cost of servicing debt and the government deficit
- At the same time, depreciates the exchange rate and rises inflation

The response requires a combination of contractionary fiscal and monetary policies

... but the precise combination has implications for welfare

The model provides incentives to smooth the use of both instruments

Some Comments

- The model provides a lot of useful insights about fiscal and monetary policy coordination
- While the intuition behind the impulse responses and welfare results seems right
 - It is hard to know how do they depend on parameter values
 - Specially, since a calibration or estimation of the model is not presented
- The quantitative role of each different channel could be further explored
 - Eliminating, for instance, the risk premium channel and recomputing the impulse responses
- The COVID scenario has an implicit identification strategy
 - Only risk premium, oil price and output gap shocks affect each of these three variables
 - This strategy should be made explicit and probably defended