

Discussion of "Nominal Anchors and Real
Consequences: Inflation Targeting, Debt, and
Investment" by N. Caramp and S. Singh

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Aggressive inflation targeting can explain 4 facts:

- ① Decline in real returns on nominal bonds
- ② Rise in private debt
- ③ Decline in investment
- ④ Rise in excess returns on capital

Decline in real interest rates

- Take optimality conditions for holding one period nominal bonds:

$$E_t M_{t,t+1} \frac{R_t^n}{\pi_{t+1}} = 1$$

where $M_{t,t+1}$ is the sdf, R_t^n nominal rate, π_{t+1} inflation.

- Real returns are:

$$E_t \frac{R_t^n}{\pi_{t+1}} = \frac{\left[1 - \text{Cov}_t \left(M_{t,t+1}, \frac{R_t^n}{\pi_{t+1}} \right) \right]}{E_t M_{t,t+1}}$$

- If π_{t+1} is high when $M_{t,t+1}$ is high, $\text{Cov}_t \left(M_{t,t+1}, \frac{R_t^n}{\pi_{t+1}} \right) < 0$
→ stabilizing inflation lowers real returns.
- What does inflation stabilization do to $M_{t,t+1}$?

Increase in private debt

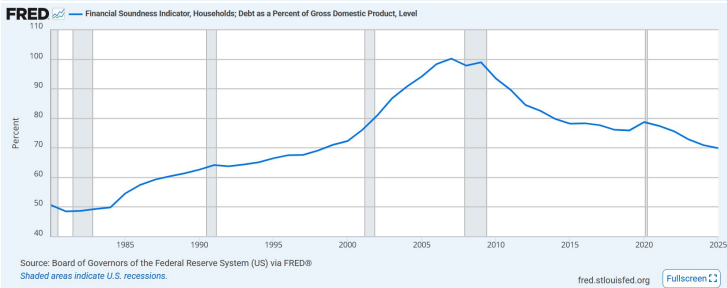
- In the model quantity of private debt is pinned down by borrowing constraint:

$$b_t = \frac{d}{R_t^r}$$

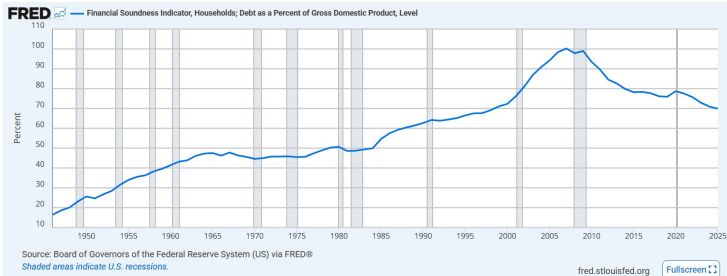
where R_t^r are real returns on debt.

- Inflation stabilization lowers real returns R_t^r and hence b_t increases.
- Interesting to also explore settings with elastic borrowing demand.
 - How does covariance of borrower sdf and inflation change?
 - Do lower rates bring in additional demand?

Real rates and private debt in the data



Real rates and private debt, pre and post 1980s



- Inflation targeting does nothing to investment in an economy with no private debt.
 - In this economy you have monetary neutrality.
- In an economy with positive debt, increasing inflation targeting reduces capital investment.
 - Nominal bonds become more attractive and investment in nominal bonds crowds out investment in capital.

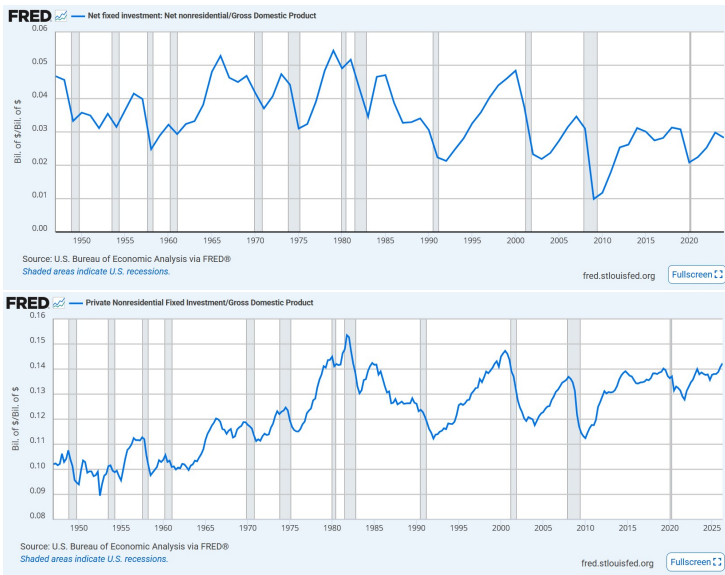
- In the model optimality for capital holdings is:

$$1 = \beta E_0 \left(\frac{C_0}{C_2} \right)^\gamma \alpha K^{\alpha-1}$$

$$1 = \beta E_0 \left(\frac{Y_0 - K - b_I}{AK^\alpha + Y_2 + \frac{b_I}{(1-\lambda)Q'_0\Pi_1}} \right)^\gamma \alpha K^{\alpha-1}$$

- Conduct analysis around $b_I = 0$.
- Does it depend on b_I ?

Net investment and Gross investment



- Very interesting and thought provoking paper.
- Need some more work on clarifying the channels of investment crowding out.
- It would be interesting to extend to a formal quantitative study of alternative factors that could explain the observed trends.