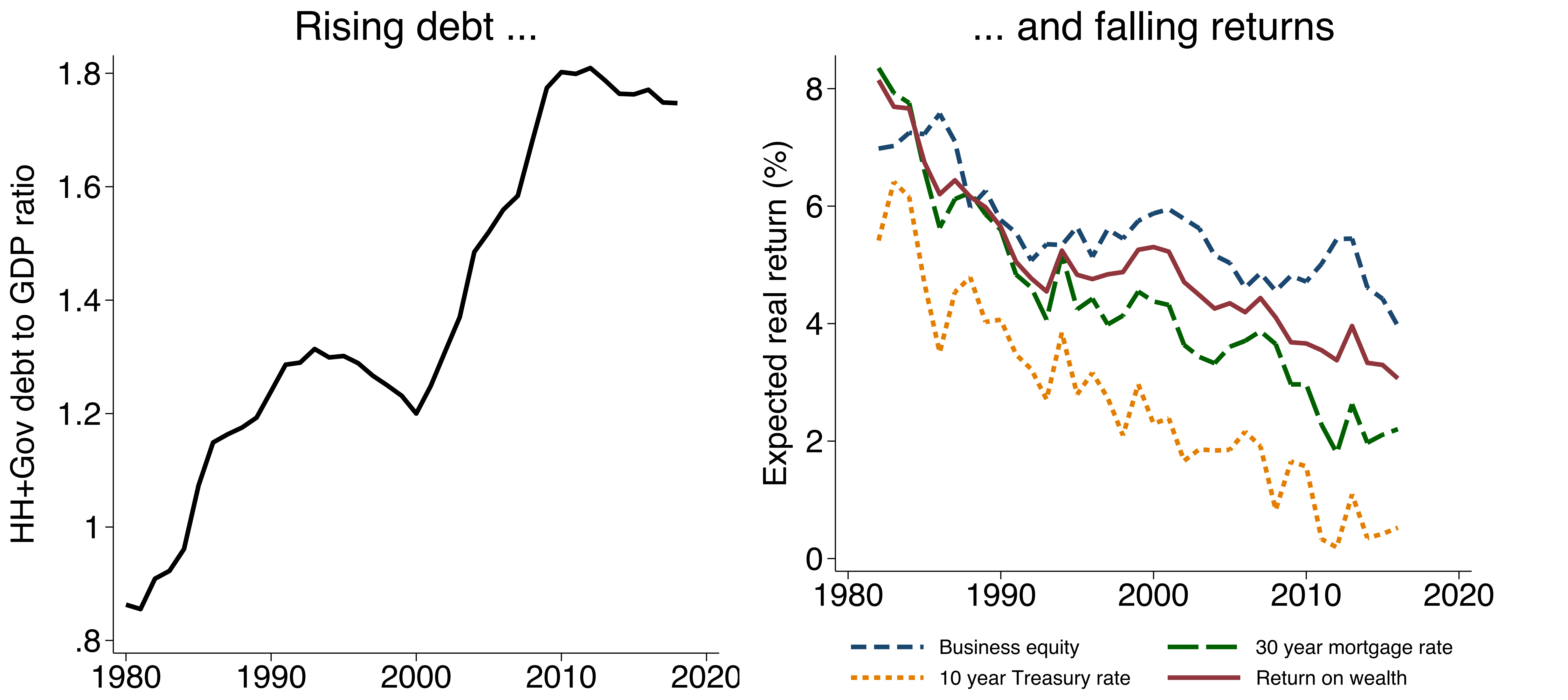
INDEBTED DEMAND

AND IMPLICATIONS FOR MONETARY POLICY

Ludwig Straub

(based on work with Atif Mian and Amir Sufi)

RISING DEBT AND FALLING RETURNS



➤ Standard story goes from right plot to left: reduced interest rates increase debt levels.

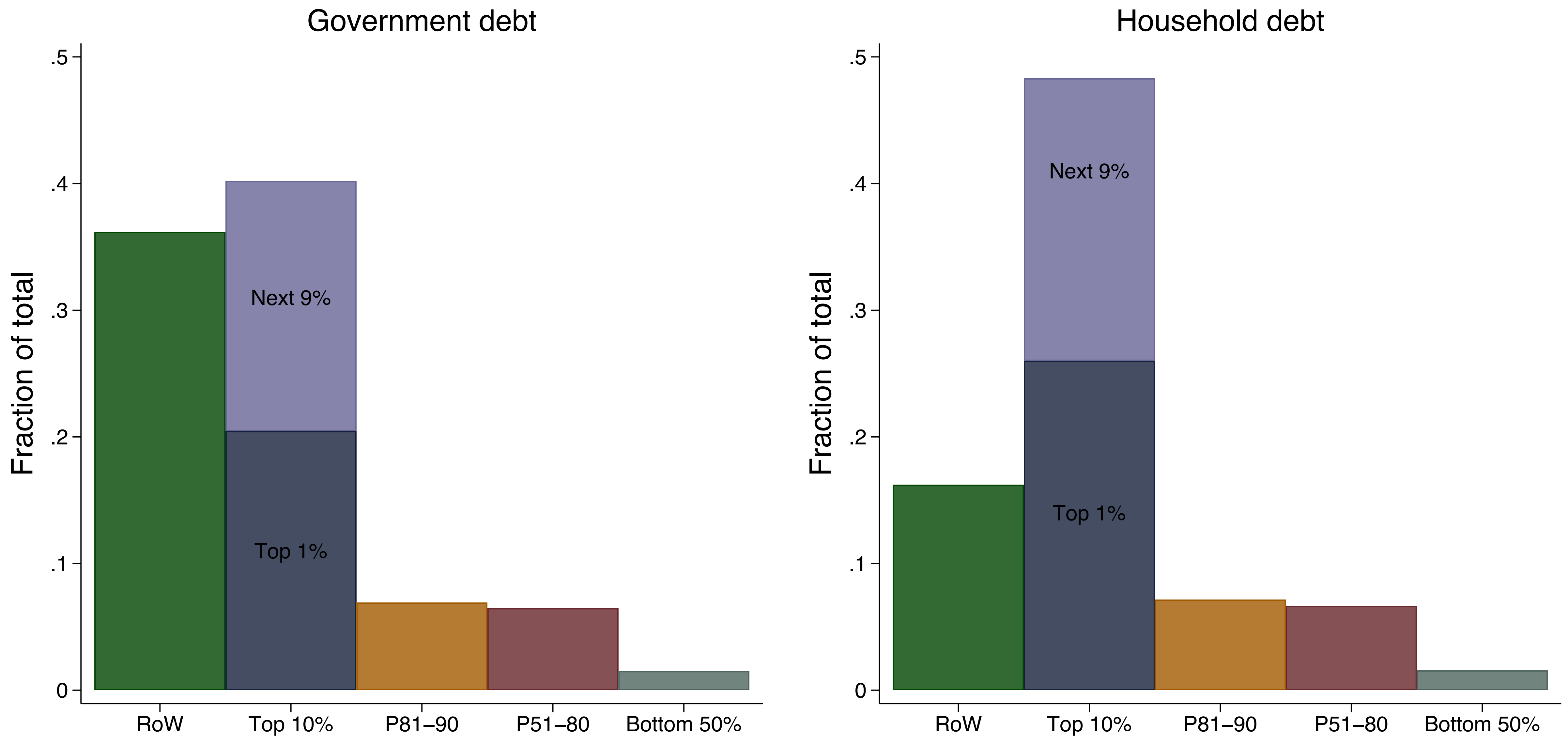
TODAY: FROM HIGH DEBT LEVELS TO LOW INTEREST RATES

- Explore a complementary story, going the other way:
  - high levels of debt …
  - cause high debt service payments …
  - reducing aggregate demand if MPC of borrower > MPC of saver …
  - pushing down r* !

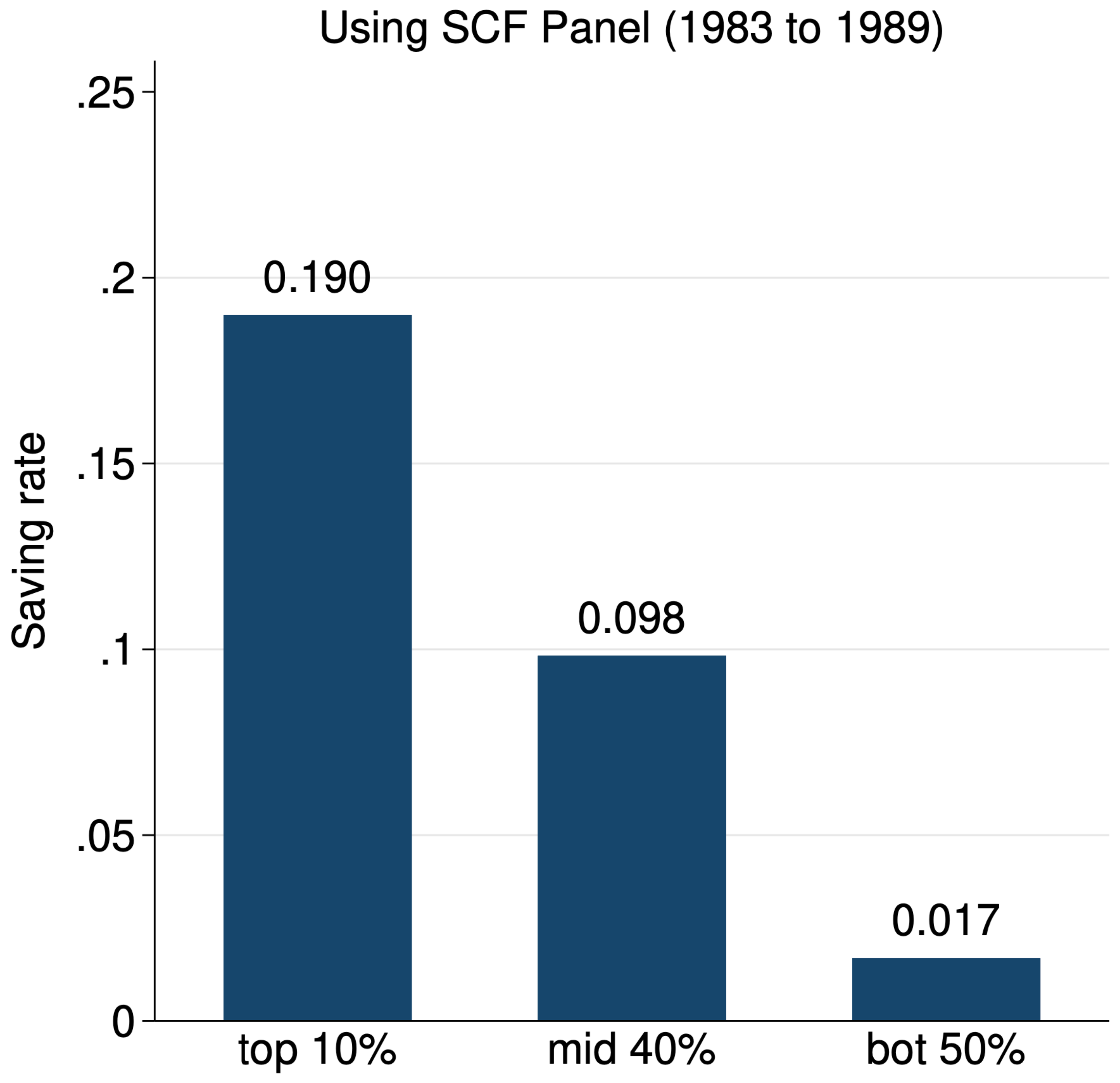
- In other words:
  - When debt levels are high, monetary policy has a hard time normalizing rates!

DO SAVERS HAVE GREATER SAVING RATES?

- Identify savers as top 10% & foreigners, then compute their saving rates.



Mian Sufi Straub (2021): "Saving Glut of the Rich"



Mian Sufi Straub (2021): "What explains the decline in r? …"*

THE INDEBTED DEMAND FRAMEWORK

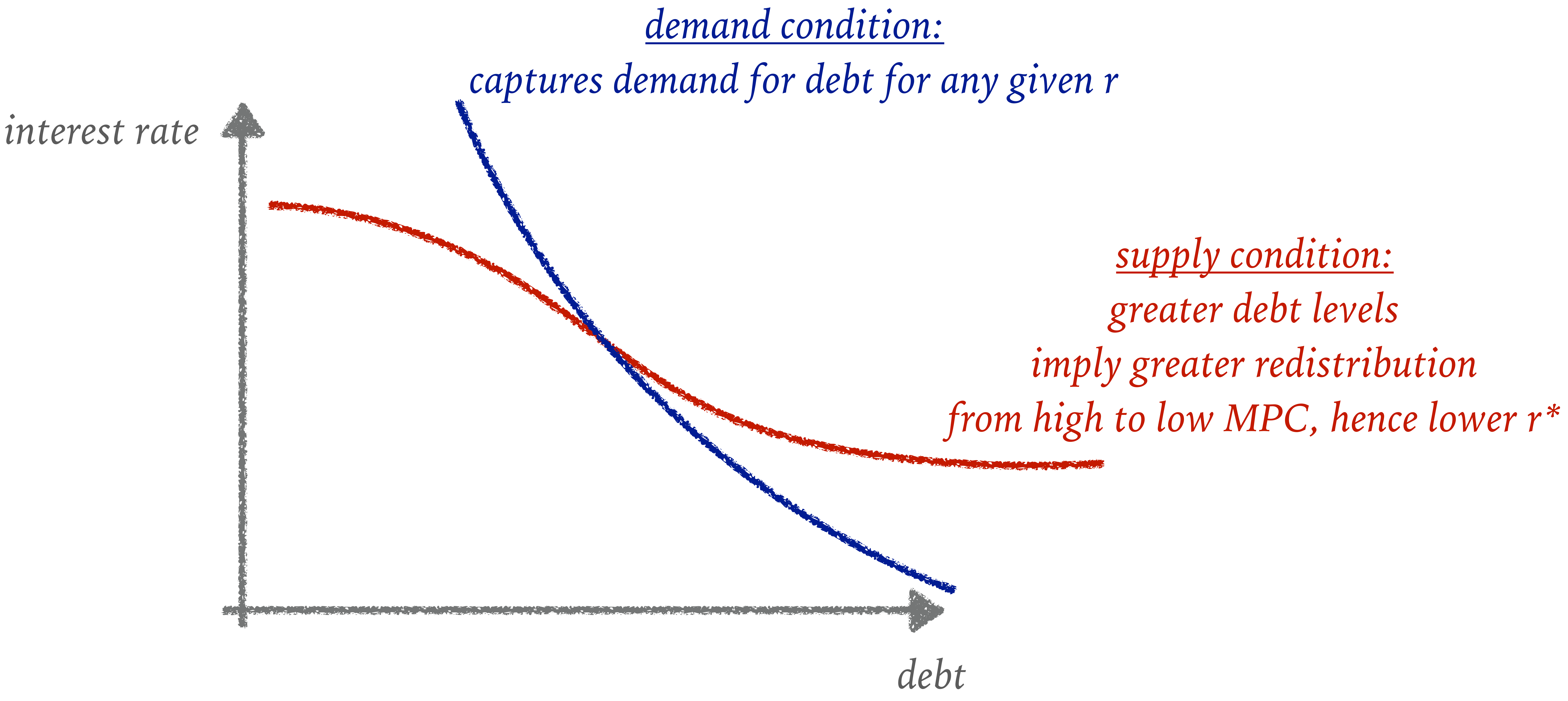
- Stylized model, matches the key features. Rich savers, poor borrowers.

- Main insight: Increased debt levels give rise to an increased resource flow from borrowers to savers, which reduces aggregate demand, and hence r*

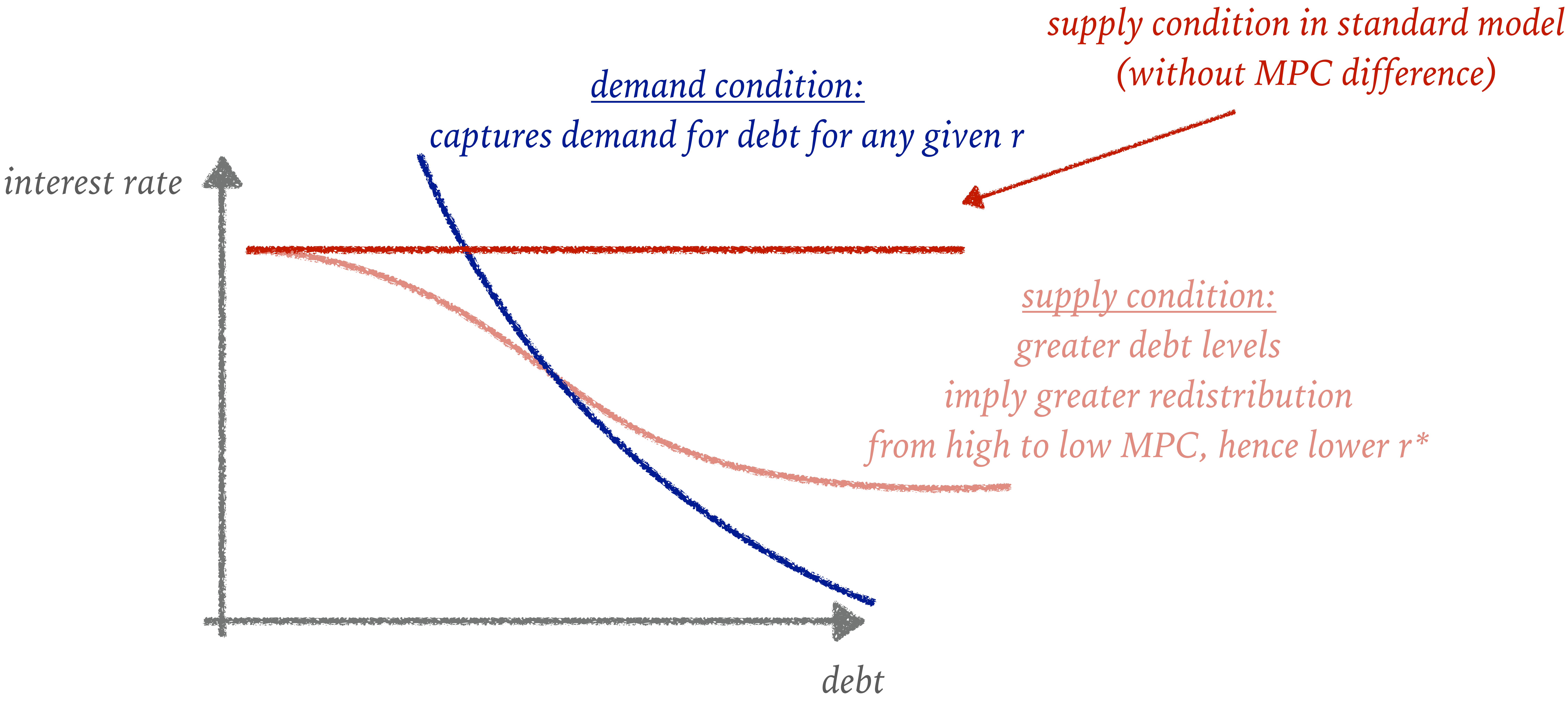
- Implications for recent trends in inequality and financial deregulation, monetary policy, redistribution

- Next: explain framework & implications graphically

THE INTEREST RATE – DEBT DIAGRAM

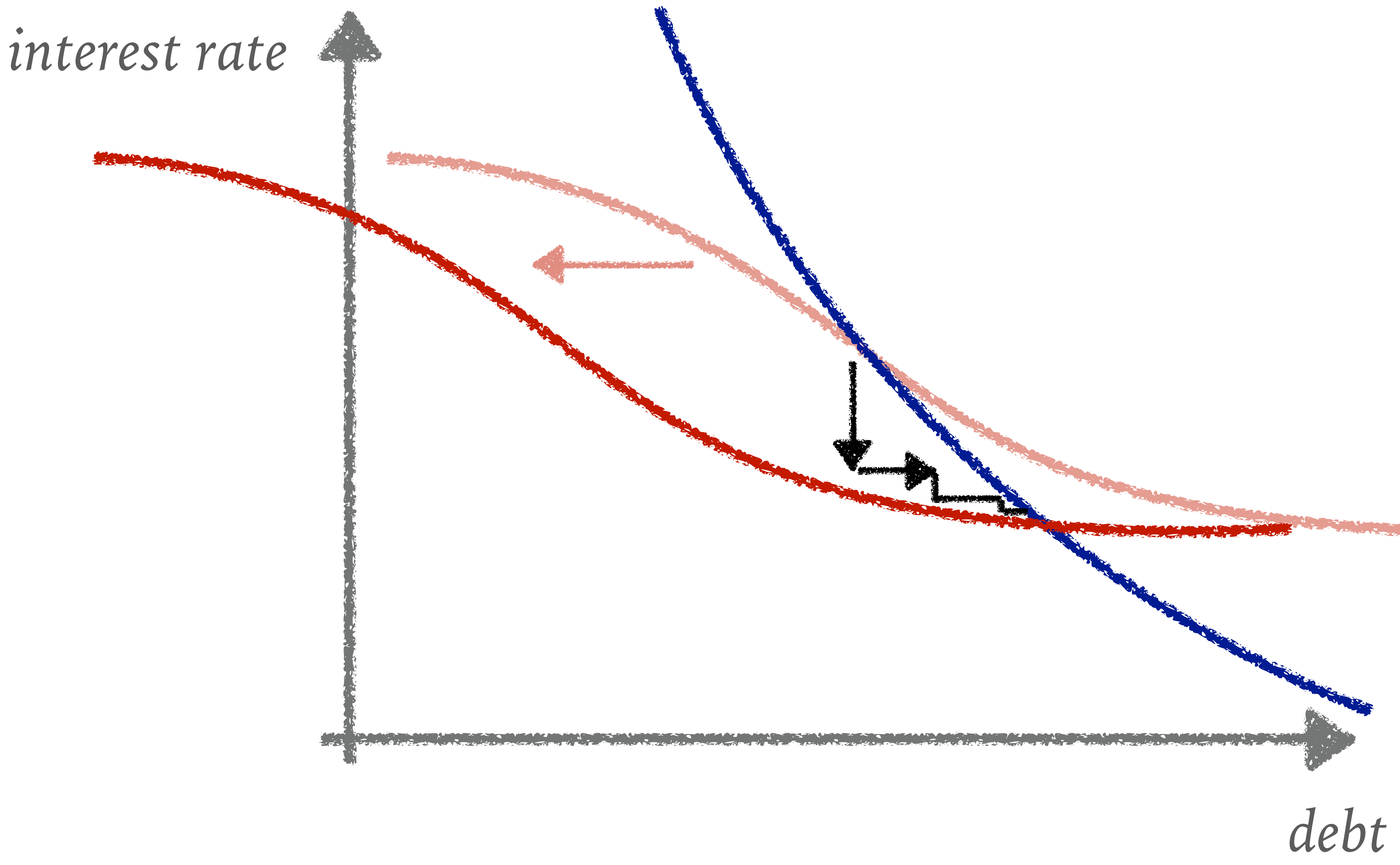


THE INTEREST RATE – DEBT DIAGRAM



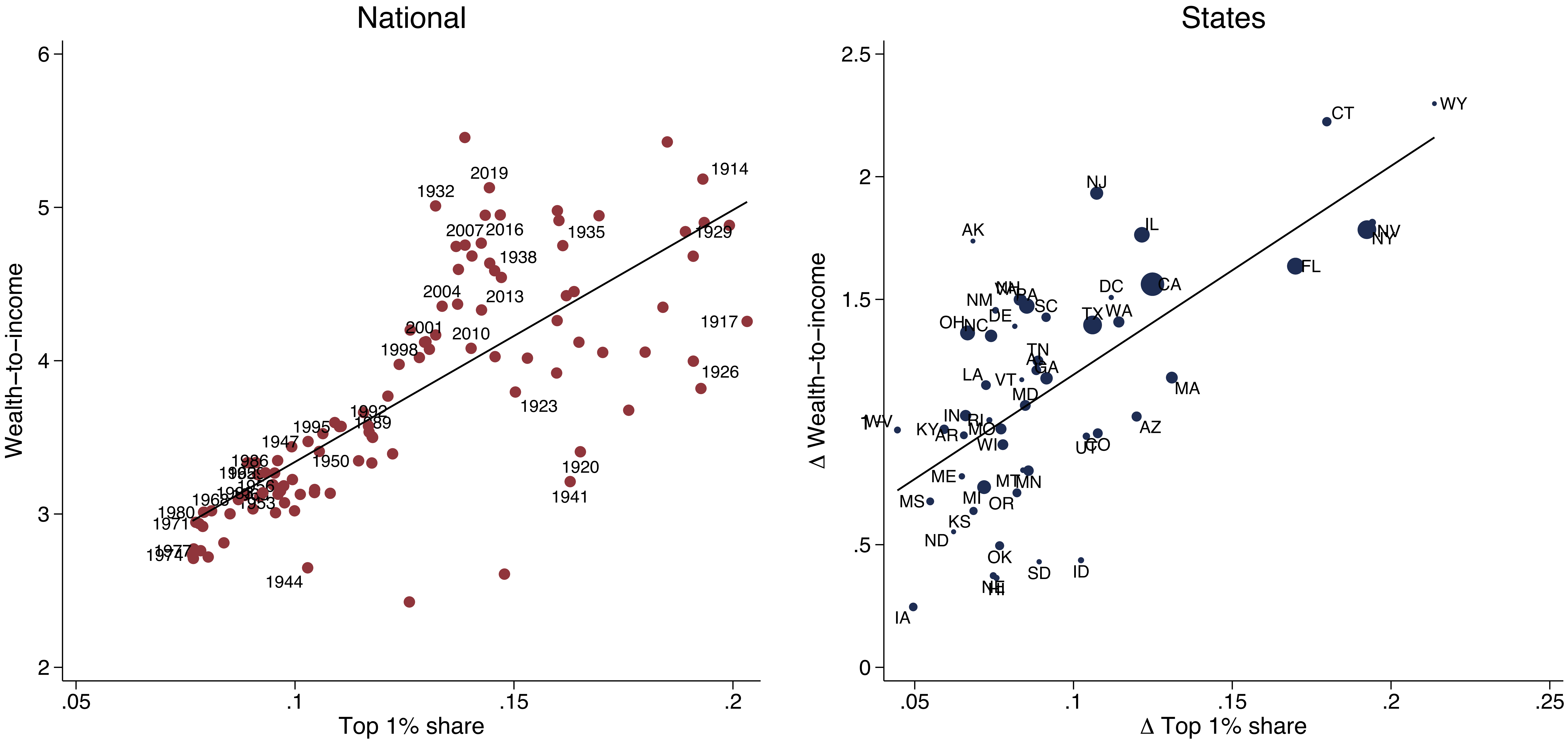
IMPLICATIONS FOR RISING INEQUALITY: FALLING R* AND RISING DEBT

- Rising inequality shifts resources from poor to rich
- All else equal reduces r*, stimulates debt, which reduces r* even more, etc…



CAN SEE DIRECT EVIDENCE OF THIS IN THE DATA

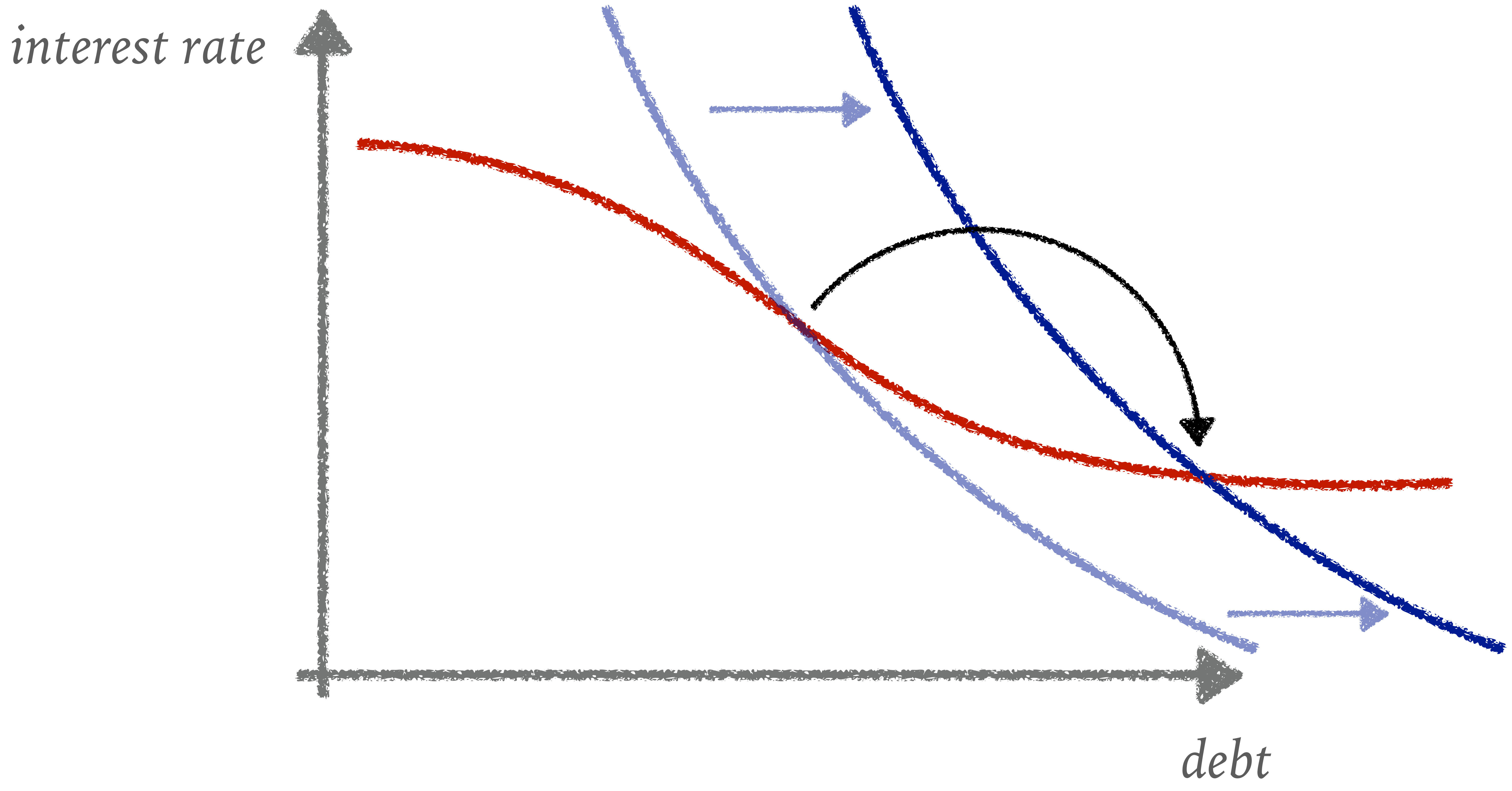
➤ Left: Over time, national level. Right: Across U.S. states



Mian Sufi Straub (2021): "Saving Glut of the Rich"

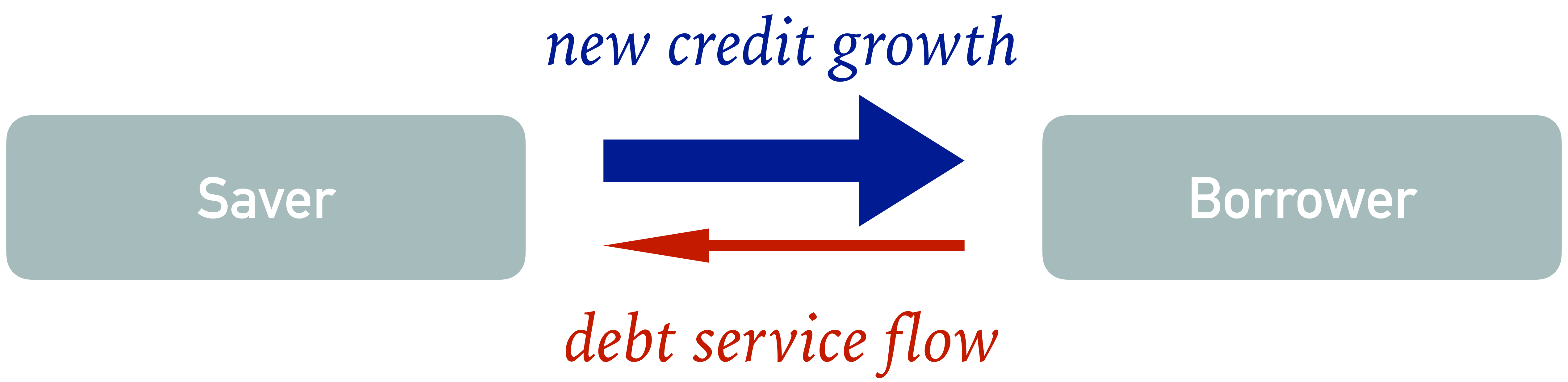
IMPLICATIONS FOR FINANCIAL DEREGULATION: BOOM & BUST

- Financial deregulation induces boom & bust episode

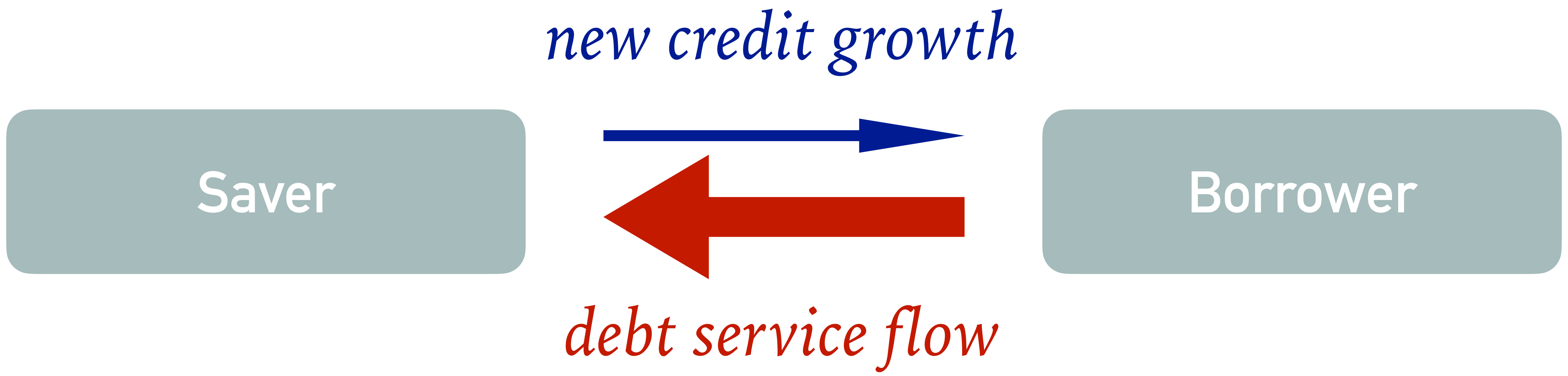


IMPLICATIONS FOR FINANCIAL DEREGULATION: BOOM & BUST

- Financial deregulation induces boom & bust episode
- Boom phase: credit expands, demand increases, r* rises
  - flows go from saver to borrower

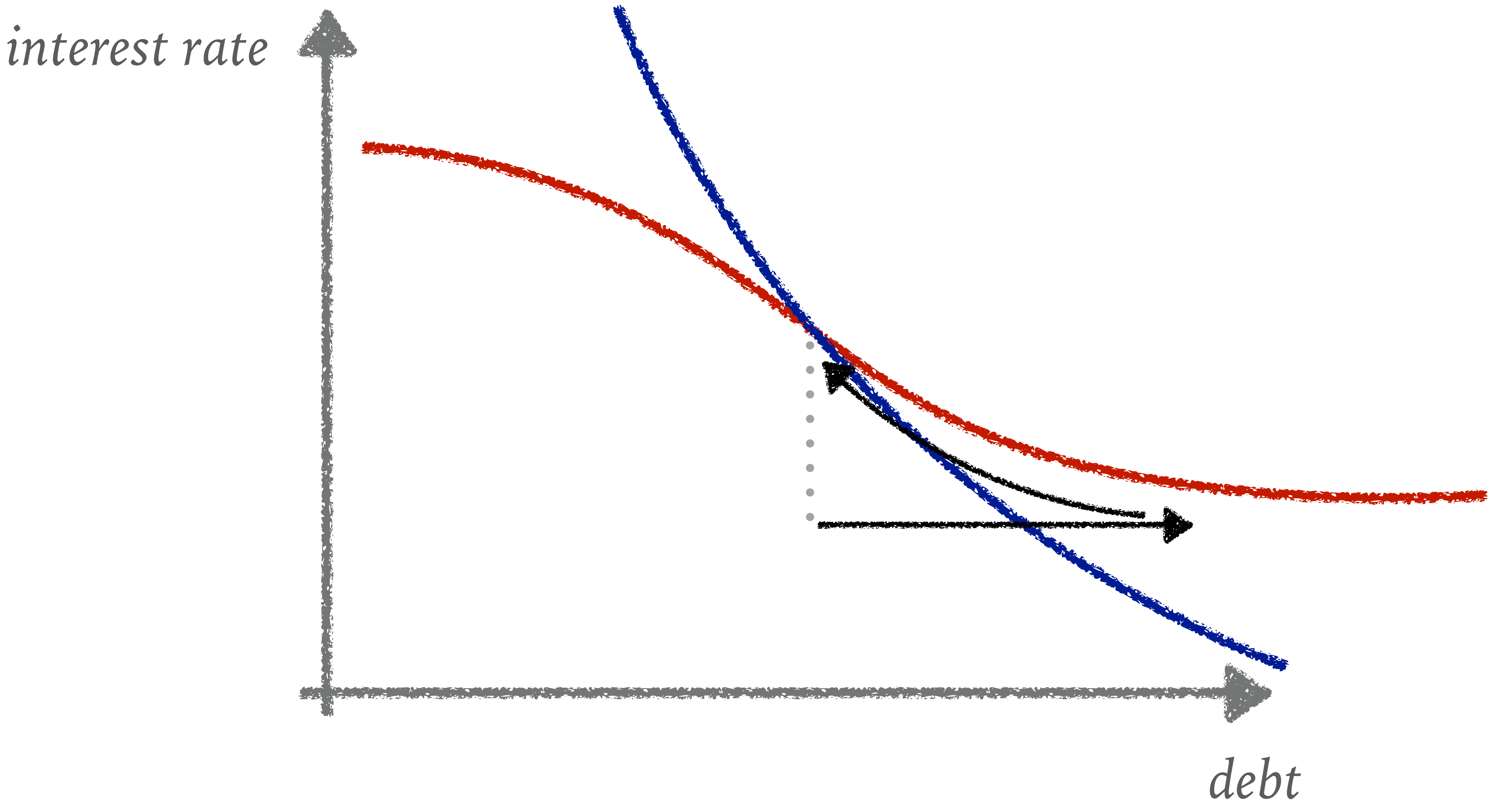


- Bust phase: new credit stalls, debt service flows > new credit growth



MONETARY POLICY AFFECTS R*

- Imagine a rate cut. Debt levels start rising, adding to demand.
- However, once stimulus should be faded out, debt burden reduces demand, r* lower.
    - Monetary policy affects r*, no “natural rate hypothesis”.



ZLB AND DEBT TRAP

- Once debt is sufficiently high, r* is so low that economy is at ZLB. “Debt trap”.
- Not so easy to resolve !
  - e.g. macroprudential policies to reduce credit creation will reduce demand

- Better policies resolve imbalances between savers and borrowers, i.e. inequality
  - many ways to do this, ranging from redistribution to progressive taxes

- In currency area context, saver & borrower could be different countries
  - redistribution could take the form of payments from “North” to “South”

TAKEAWAYS

- Indebted demand = idea that demand falls when debt service flows are high.
- Implies that …
  - rising inequality causes low r* and high debt.
  - financial deregulation causes boom-bust episodes.
  - monetary policy has effects on r*, breaking natural rate hypothesis.