Questions for the UK's Monetary Policy Regime after the Crisis

By Durre, Manea, Paul and Pill

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My comments will be focussed on three main subjects:-

1) Macro-modelling strategy;
2) Points of difference with the authors;
3) Current policy issues

There is much that is excellent about this paper, and I hope that the authors will excuse me if I focus more on points where we may differ.

Macro-modelling Strategy

Assertion: Financial frictions are more important than wage/price stickiness (1929-33 USA; 1991 – date Japan; 2007-9 DM).

These are not captured well by Neo-Keynesian sticky wage/price DSGE models. Financial frictions depend on default being a real possibility, especially default of banks (Lehman, Credit Anstalt, RBS, etc.). With zero default, no need for money nor intermediaries. Economists such as Christiano, et al., now include corporate default, but not yet bank default, although latter is more important. Not clear to me how Durre/Pill model banking difficulties.

Points of Difference

P. 10: 'In normal times financial quantities in general irrelevant: *money does not matter*'.

Only true under *extremely restrictive* assumptions.

Throughout: Nothing on housing and CRE.

Shocks: Demand for bank notes automatically met. Only significant for Q4 2008 and Q1 2009.

Why might households be unwilling to deposit at banks unless solvency fears? Anyhow run came from informed wholesale, uninsured creditors, not from retail deposits.

IOER: What would be difference (costs/benefits) if commercial banks held T Bills, instead of ER? Why would natural real rate be lower if banks held TBs instead? Why should bank liquidity influence real rates of interest?

Policy Options

(1)	Changing the inflation objective	No!
(2)	Getting rid of cash	Part way
(3)	Press on with QE	No!
(4)	Helicopter Money, Corbyn and People's QE	Part way
(5)	Switch debt finance to equity finance	Yes
(6)	Start raising rates sooner rather than later.	