Discussion of “Convenience Yields and Financial Repression”

Payne and Szoke

Francesco Bianchi

Johns Hopkins University
NBER & CEPR

Summary

This paper contributes to the literature studying **convenience yield** and **safe assets**:

- The paper provides a theoretical explanation for the convenience yield based on financial repression
- Financial repression affects convenience yield in a direct and indirect way
  - The indirect channel is particularly interesting because less mechanical
  - During bad times, regulation can induce an increase in demand for govt debt, driving up its price, and making it a good hedge $\Rightarrow$ larger convenience yield
  - However, for govt debt to be a safe asset, fiscal responsibility is necessary
  - Default erodes the value of debt in bad times, reducing its role of hedge, and ultimately lowering the convenience yield

General comments

- I really enjoyed reading this paper
- The key mechanisms are very clearly explained and interesting
- The paper makes a clear and interesting connection to fiscal policy and shows the importance of modeling the preference for govt bonds endogenously
- I will focus on some modelling assumptions that I find interesting

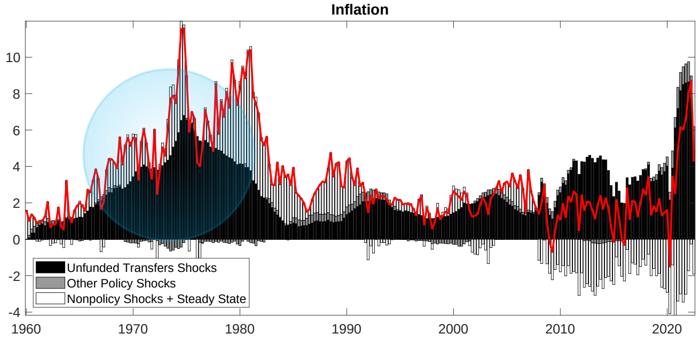
Comment 1: Is government debt like any other debt?

- In the model, ”absent regulation, there is no special role for government debt?”
    1. Natural starting point, given the focus on financial regulation
    2. But perhaps a strong assumption for countries that issue debt in their own currency?
    3. Debt is real in the model
    4. Authors talk about explicit and implicit default. Is implicit default due to inflation?
    5. Are the two types of default equally costly for banks? Fiscal inflation has some benefits if monetary policy is ineffective.
- Paper makes a lot of progress, perhaps role of inflation could be developed in a follow-up paper
- This would further strengthen the connection to the literature on monetary/fiscal policy interaction

Comment 2: Financial Repression and Fiscal Inflation

- Fiscal policy follows an exogenous process $\Rightarrow$ unpleasant monetarist arithmetic
    1. In monetary/fiscal policy interaction literature, bad fiscal outcomes lead to inflation
    2. In this paper, they lead to financial repression
- Quite likely, both channels are at work
- Do they reinforce each other?

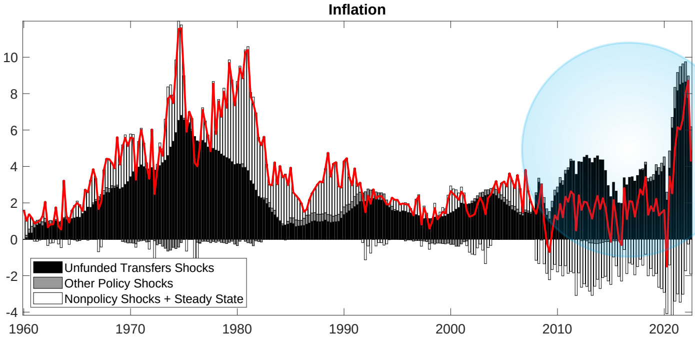
Fiscal Inflation



Unfunded transfers shocks (Bianchi, Faccini, Melosi, QJE 2023): BEI

1. Accounts for rise of trend inflation in the 1960s-1970s and decline in the 1980s
2. Offsets the deflationary bias since early 1990s, post-COVID acceleration

Fiscal Inflation



Unfunded transfers shocks (Bianchi, Faccini, Melosi, QJE 2023): BEI

1. Accounts for rise of trend inflation in the 1960s-1970s and decline in the 1980s
2. Offsets the deflationary bias since early 1990s, post-COVID acceleration

Financial Repression

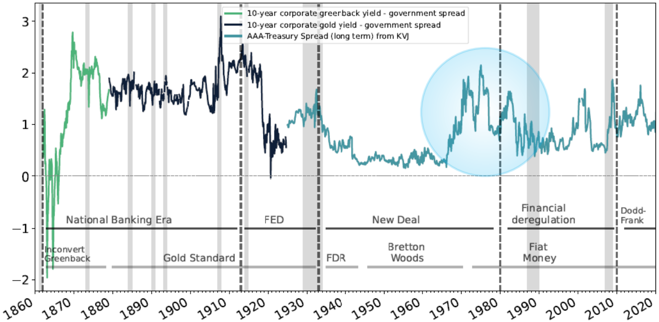


Figure 8: The Convenience Yield: 1860-2020

Convenience yield (Payne and Szoke):

1. High in the 1960s-1970s and briefly in the early 1980s
2. High again in the post-Millennial period

Financial Repression

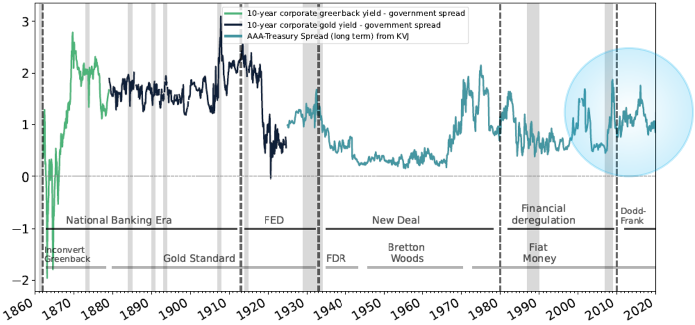


Figure 8: The Convenience Yield: 1860-2020

Convenience yield (Payne and Szoke):

1. High in the 1960s-1970s and briefly in the early 1980s
2. High again in the post-Millennial period

Comment 3: $r < g$

- The authors results could also be interesting to inform the $r < g$ debate
- In models of monetary/fiscal policy interaction, $r < g$ arises if the central bank accommodates large spending shocks
- Here, $r < g$ arises because of financial repression
- **Key insight**: convenience yield is endogenous, and so it is the observed r
  1. Lowering the real interest rate requires a certain level of fiscal discipline
  2. Additional fiscal space exploitable only to some extent

Comment 4: Bank's risk aversion

- A key role is played by the cost of default potentially sustained by banks
- Because of this cost, banks act as if they were more risk averse than households
- This is an interesting perspective, but it would be important to understand the broader implications
- There are models in which banks and financial intermediaries are less risk averse
- One interpretation: Perhaps banks carry more aggregate risk because of loans

Conclusions

- A **very interesting and innovative paper**
- Provide credible explanation for convenience yield
- Useful to make predictions on its evolution, as opposed to taking it as given
- Laboratory to develop the connection between financial repression and fiscal policy
- It will be interesting to understand the broader macroeconomic implications