



# NEWSLETTER

2022



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## EDITORIAL

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This Newsletter briefly reports about the Center's activities in the past year and the agenda for the months ahead. It also contains an interview with Javier Bianchi who taught one of the advanced doctoral courses in the summer, and informs about other developments at the Center.

Due to Covid-19, we look back at another difficult year—"Gerzensee online" is not the same as the "real" thing. Nevertheless, the Study Center organized a record number of courses, many online or in a hybrid format. The conference highlight was the event with the *Journal of Economic Dynamics and Control*, featuring papers on topics in the intersection of macroeconomics and epidemiology. I would like to warmly thank

our partner institutions and everybody who contributed to the Center's activities. We very much appreciate the support and the collaboration!

Looking ahead, we plan a series of events in 2022. These include the bi-annual conference with the *Journal of Monetary Economics*, jointly with the Swiss National Bank; conferences with the Swiss Finance Institute and the Centre for Economic Policy Research; six central bankers courses; a new instance of the Swiss Program for Beginning Doctoral Students; as well as many advanced courses in economics and law and economics courses. We hope for the best but plan for a combination of on-site, hybrid, and online events.

After 12 years as the Director of the Study Center, I will step down in February to return to academia full time. Martin Brown will succeed me in April and Sylvia Kaufmann will continue as the Deputy Director of the Center (see page 8). I wish both the very best and much success at the helm of this wonderful institution. And I hope to stay in touch with many of this Newsletter's readers; you can reach me at the University of Bern or via [www.niepelt.ch](http://www.niepelt.ch).

With best wishes,

Dirk Niepelt  
Director

## INTERVIEW WITH JAVIER BIANCHI <sup>1</sup>

*Let us start with monetary policy implementation. In a paper with Saki Bigio you argue that the way monetary policy is implemented matters for the macroeconomy. Could you explain why?*

My paper with Saki Bigio provides a unified framework to study the implementation and the transmission of monetary policy. One of the things we find is that the pass-through from the policy rates to the banks' lending rate depends on the overall liquidity in the interbank market. To the extent that it is the lending rate that matters for the level of aggregate demand, this implies that to understand how monetary policy ultimately affects economic activity, it is therefore essential to consider the financial plumbing of the banking system.

*The standard New Keynesian model, which is widely used to discuss monetary policy, excludes this plumbing from its setup. Should central bank economists move away from basic New Keynesian models and think more about the functioning of interbank markets?*

Let me give you a concrete example of how the implementation of monetary policy matters. Imagine a central bank that wishes to raise the target for the interbank market rate by 1%. Suppose it implements the tightening with open market operations. We find that in this case, the increase in the banks' lending rate is lower compared to a situation where the central bank raises the corridor rates. And so the choice of the target for the interbank market rate must be considered jointly with the choice of how to implement the target. This is unlike what we typically see in central bank policy discussions, where these decisions are disconnected for the most part.

So to answer your question, I would not say that central banks should move away from New Keynesian models. I would argue, however, that it is essential that models used at central banks incorporate interbank market frictions if we want to gain a better understanding of how monetary policy decisions will affect economic activity.

*Pressures on bank funding usually appear first in the interbank market. In a recent paper with Manuel Amador, you show that the competitive equilibrium has too few bank failures relative to the optimum. Could you explain the mechanics of this surprising result, and does it mean that we should get*

*rid of the lender of last resort (and/or deposit insurance) so that banks would fail more often?*

Indeed, in my paper with Manuel Amador the competitive equilibrium may feature too few bank failures. This occurs when financial crises are driven by fundamentals. The mechanism has to do with a cleansing effect. When more banks fail, this keeps asset prices low and helps those banks that survive a crisis because they are net buyers of assets. Because surviving banks have a high valuation of funds, higher bank failures turn out to improve overall banks' utility. In this context, policies aimed at preventing bank failures are a bad idea.

However, the opposite happens when defaults are driven by self-fulfilling runs. In this case, defaults are inherently inefficient in the sense that a bank's default results from a coordination problem, and so policies oriented at making banks less fragile are welfare improving. These findings highlight that the financial stability implications of central bank policies depend crucially on whether financial crises are driven by fundamentals or self-fulfilling runs.

*In that same paper you also study the consequence of "credit easing" — that is, asset purchases by the government that are debt financed — on financial stability. What are the main insights from your analysis, and what are the main lessons we can learn for the current post-COVID situation where governments have been purchasing private debt to support the economy?*

There is a prevalent view that in a financial crisis, central banks should engage in credit easing, purchasing private assets in secondary markets. The idea is that this can mitigate financial disruptions and the potential negative consequences in the real economy. This view was notably articulated by former Chairman Ben Bernanke in the speech "The Crisis and the Policy Response" in January 2009. More recently, during the COVID crisis, we've seen central banks following this policy recipe. Our analysis, however, shows that credit easing is not desirable or effective when a crisis is driven by fundamentals. The logic is that asset purchases lower the return on private assets and crowd out banks, reducing their incentives to repay. Credit easing therefore turns out to backfire, leading to more banks defaulting. Moreover, under the plausible assumption that the return on assets held by the central bank is not higher than on those

held by investors, we demonstrate that credit easing generates welfare losses.

When a crisis is driven by self-fulfilling runs instead, credit easing is effective at reducing financial fragility. Asset purchases increase asset prices and, in effect, provide liquidity to a bank facing a run. The key idea is that higher asset prices allow a bank facing a run to obtain higher revenues from selling assets to service the maturing bonds. In equilibrium, investors have fewer incentives to run because they anticipate that the bank will not default even if it faces a run. If the intervention is large enough, the banking system may become run-proof.

*Going forward, do you think that the ballooning public debt due to COVID will affect monetary policy considerations differently in advanced and emerging economies? And will there be different monetary and fiscal responses in those two types of economy?*

I think that the monetary-fiscal interactions highlighted by Sargent and Wallace's unpleasant monetarist arithmetic 40 years ago will be central going forward. This is especially the case for many emerging markets that have been increasingly issuing debt in domestic currency. The temptation to inflate away the debt will certainly be an issue if they see sudden increases in sovereign spreads. In addition, concerns about fiscal dominance may complicate the use of monetary policy to stabilize macroeconomic fluctuations. Managing these trade-offs will be more challenging for countries with more limited credibility regarding their fiscal and monetary frameworks. So to answer your question, my conjecture would be that even though advanced economies have experienced a more substantial increase in public debt, it is probably emerging markets that would be more on the hook.

In this context, the European Commission is discussing a reform of the fiscal framework that can help provide more space to use fiscal policy for macroeconomic stabilization in times of downturns. Similarly, the IMF has been pushing for the adoption of fiscal rules. In my work with Pablo Ottonello and Ignacio Presno, we show that a government that lacks commitment to repay the debt has incentives to follow a procyclical fiscal

<sup>1</sup> These are the views of Javier Bianchi and do not necessarily reflect the views of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.



*Javier Bianchi is a senior research economist at the Federal Reserve Bank of Minneapolis and a co-editor of the Journal of International Economics. Javier Bianchi is a recipient of the Excellence Award in Global Economic Affairs from the Kiel Institute for the World Economy. His work has been published in several leading journals including the American Economic Review, Journal of Political Economy, the Review of Economic Studies, and the Journal of International Economics, and has been funded by the National Science Foundation. His research covers topics in international macroeconomics, macroeconomics, macrofinance and monetary economics.*

policy. Facing higher sovereign spreads in a recession, the government finds it optimal to resort to more austere policies at the expense of a deeper contraction in economic activity. The challenge going forward is to develop a fiscal framework that is both credible and flexible. This is not easy to do.

*Also, what will be the implications for economies in a monetary union, like the ones in the eurozone? Usually, economies can inflate their debt away, but economies opting for a monetary union relinquished that option. In a recent paper with Mondragon, you show that the cost for the Spanish economy of sacrificing monetary independence is a sixfold increase in the likelihood of rollover default. Could you explain the mechanism leading to such a large effect? For the eurozone, is the result in your paper speaking in favour of a "euro bond"?*

In my paper with Jorge Mondragon, we argue that the lack of monetary independence has made countries in Southern Europe more vulnerable to a rollover crisis. However, the reason is not the inability to inflate away the debt—in fact, we abstract from this force by considering a model with real debt. The logic of our result is as follows. When creditors fear others will stop lending to the government, they refuse to roll over the government bonds, forcing it to tighten spending or raise fiscal revenues. In the absence of an independent monetary policy (i.e., in the presence of a monetary union), a demand-driven recession unfolds and defaulting becomes more tempting for the government. As a result, a country within a monetary union becomes more vulnerable to a rollover crisis. By contrast, a government that has a flexible exchange rate can respond to the investors' panic by letting the exchange rate depreciate and mitigate the recession. Because investors anticipate that the government will respond with monetary policy, this reduces the region of vulnerability to a rollover crisis.

Regarding the question on euro bonds, I think that instrument can help with other issues regarding the broad circulation of a liquid asset. The main lesson from our analysis is that governments in the euro area need the ECB to be a lender of last resort.

*Relatedly, the SNB is purchasing euro-denominated assets in order to counter appreciation pressure on the Swiss franc. In a paper with Amador, Bocola, and Perri, you show that such interventions may be costly at the zero lower bound. Could you explain why?*

My paper with Amador, Bocola, and Perri is concerned with a situation in which a central bank cannot counter appreciation pressures by using conventional monetary policy because of the effective lower bound—a situation that the SNB has recently experienced. It is well-known that with perfect capital markets, there is little the central bank could do to resist the appreciation because the interest parity condition places strong restrictions on the path of the exchange rate. In an environment featuring limits to international arbitrage, we argue that purchases of international reserves can help to resist the appreciation pressures on the exchange rate but that this intervention is costly.

The mechanism is that accumulating reserves leads to an increase in the real rate on domestic currency bonds. This is because households try to offset the increase in reserves by borrowing more, but investors have limited pockets to lend. So when the central bank accumulates reserves, it opens up a deviation from the interest parity condition. Given the nominal rate, this leads to a temporary depreciation of the exchange rate. Critically, the expected appreciation implies that foreign investors end up obtaining profits at the expense of the central bank. We then show in the paper that the costs of the FX intervention can be computed as

the stock of international reserves times the deviation from covered interest parity. For the case of SNB, we find that these costs peaked at about 0.6% of monthly gross domestic product.

*In a broader context, you analysed foreign reserves holdings and accumulation in a paper with Cesar Sosa-Padilla, arguing that a government that increases its debt, while accumulating reserves at the same time, may not face increasing borrowing costs. Given public debt increased in most countries, what are the implications for the optimal foreign reserves management going forward?*

My paper with Cesar Sosa-Padilla provides a theory of a macro-stabilization hedging role for international reserves. The idea is that when a country faces a negative shock and spreads increase, the availability of liquid assets allows the government to manage the recession better without the need to borrow at high interest rates. Moreover, the availability of reserves in these circumstances reduces the temptation to default on the debt. It is because of this reason that a country that issues debt to accumulate reserves may see very limited increases in sovereign spreads.

Given these findings and the previous discussions, I find it a bit puzzling that countries in the eurozone hold almost no international reserves. My view is that ongoing reforms of the fiscal framework in the European Union should pay more attention to portfolio considerations.

*Thank you very much Javier for this interview.*

Cyril Monnet conducted this interview.

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## ACADEMIC CONFERENCES

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### RESEARCH DAYS AND SWISS DOCTORAL WORKSHOP IN FINANCE

June 6–8, 2021, jointly with Swiss Finance Institute (cancelled)

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### EUROPEAN SUMMER SYMPOSIUM IN ECONOMIC THEORY

July 5–16, 2021, jointly with CEPR (cancelled)

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### EUROPEAN SUMMER SYMPOSIUM IN FINANCIAL MARKETS

July 19–30, 2021, jointly with CEPR (cancelled)

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### OTHER EVENTS

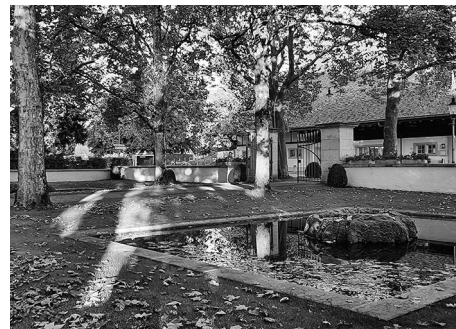
October 29, 2021

Graduation Ceremony for participants of the Swiss Program for Beginning Doctoral Students in Economics 2019/20 and 2020/21 (on-site)

November 22–23, 2021

Alumni Conference (on-site)

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**CONFERENCE WITH THE JOURNAL OF ECONOMIC DYNAMICS AND CONTROL**

**Covid-19 and the Economy**

October 14–15, 2021, jointly with the Journal of Economic Dynamics and Control, the Federal Reserve Bank of St. Louis, the Swiss National Bank, and the University of Bern (hybrid)

Optimal Management of an Epidemic: Lockdown, Vaccine and Value of Life

Authors: Carlos Garriga, Federal Reserve Bank of St. Louis, Rody Manuelli and Siddhartha Sanghi, Washington University in St. Louis

Discussant: Piero Gottardi, University of Essex

Optimal Age-Based Vaccination and Economic Mitigation Policies for the Second Phase of the Covid-19 Pandemic

Authors: Andy Glover, Federal Reserve Bank of Kansas City, Jonathan Heathcote, Federal Reserve Bank of Minneapolis, Dirk Krueger and José-Víctor Ríos-Rull, University of Pennsylvania

Discussant: Cezar Santos, Bank of Portugal

Estimating and Simulating a SIRD Model of COVID-19 for Many Countries, States, and Cities

Authors: Jesús Fernández-Villaverde, University of Pennsylvania, and Charles Jones, Stanford University

Discussant: Abigail Adams-Prassl, Oxford University

Integrated Epi-Econ Assessment of Vaccination

Authors: Timo Boppart, IIES and University of St. Gallen, Karl Harmenberg, BI Norwegian Business School, Per Krusell, IIES, and Jonna Olsson, University of Edinburgh

Discussant: Marina Azzimonti, Stony Brook University

The Political Economy of Early Covid-19 Interventions in US States

Authors: Martín Gonzalez-Eiras, University of Copenhagen, and Dirk Niepelt, Study Center Gerzensee and University of Bern

Discussant: Sang Yoon (Tim) Lee, Queen Mary University of London

Covid-19 in Segmented Societies

Authors: Constantino Hevia, Manuel Macera and Andy Neumeier, Universidad Torcuato di Tella

Discussant: Sewon Hur, Federal Reserve Bank of Dallas

Epidemics in the New Keynesian Model

Authors: Martin Eichenbaum and Sérgio Rebelo, Northwestern University, and Mathias Trabandt, Goethe University Frankfurt

Discussant: Leonardo Melosi, Federal Reserve Bank of Chicago



**Epidemics as a shock to the demand for consumption**

- Set  $\pi_2$  to zero so that  $N$  doesn't affect prob of susceptible person becoming infected.
- Calibrate  $\pi_1$  so that 1/3 of infections at beginning of epidemic are driven by  $C$ .
- Key results:
  - ▶ Relatively small recession, with  $Y$  falling from peak to trough by 0.4 and 0.6 percent.
  - ▶ Very large drop in  $C$  and enormous rise in  $X$ .

Epidemics in the New Keynesian Model Martin Eichenbaum, Sergio Rebelo and Mathias Trabandt 18 / 25

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## COURSES

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### CENTRAL BANKERS COURSES 2021

Advanced Topics in Empirical Finance (online)

External lecturers: Casper de Vries, Thierry Foucault, Michael Rockinger, Norman Schürhoff  
Monetary Policy, Exchange Rates, and Capital Flows (online)

External lecturers: Philippe Bacchetta, Giancarlo Corsetti, Philipp Harms, SNB staff  
Financial Stability (online)

External lecturers: Philippe Bacchetta, Michael Rockinger, Ernst-Ludwig von Thadden,  
SNB and Swiss Banking staff

Banking Regulation and Supervision (online)

External lecturers: Philippe Bacchetta, Martín Gonzalez-Eiras, Jean-Charles Rochet,  
Xavier Vives, Heinz Zimmermann, Finma, Postfinance and UBS staff

Macroeconomic Forecasting (online)

External lecturers: Daniel Kaufmann, Massimiliano Marcellino, Barbara Rossi, SNB staff

Advanced Topics in Monetary Economics (online)

External lecturers: Lawrence Christiano, Stephanie Schmitt-Grohé, SNB staff

Instruments of Financial Markets (hybrid)

External lecturers: Philippe Bacchetta, Amit Goyal, Michel Habib, Erwan Morellec,  
Michael Rockinger, SNB staff

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### SWISS PROGRAM FOR BEGINNING DOCTORAL STUDENTS IN ECONOMICS 2020/21 AND 2021/22

Microeconomics (hybrid, online)

Lecturers: Piero Gottardi, Johannes Hörner, John Moore, Klaus Schmidt

Macroeconomics (hybrid, online)

Lecturers: Fernando Alvarez, Jordi Galí, Sérgio Rebelo, Ricardo Reis

Econometrics (hybrid, online)

Lecturers: Bo Honoré, Mark Watson

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### ADVANCED COURSES IN ECONOMICS FOR DOCTORAL STUDENTS AND FACULTY MEMBERS 2021

Heterogeneity and Monetary Policy (online)

Lecturer: Gianluca Violante

Recent Advances in Mechanism Design with and without Monetary Transfers (on-site)

Lecturer: Benny Moldovanu

Computational Economics (hybrid)

Lecturer: Felix Kübler

Macroeconomics with Financial Frictions: Monetary and Macroprudential Policies (hybrid)

Lecturer: Javier Bianchi

Advances in Financial Time Series Modeling (hybrid)

Lecturer: Siem Jan Koopman

Recent Advances in International Finance, jointly with Swiss Finance Institute (hybrid)

Lecturer: Hanno Lustig

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### LAW AND ECONOMICS COURSES FOR DOCTORAL STUDENTS AND FACULTY MEMBERS 2021

Governance and Regulation of Blockchains and FinTech (online)

Lecturer: David Yermack

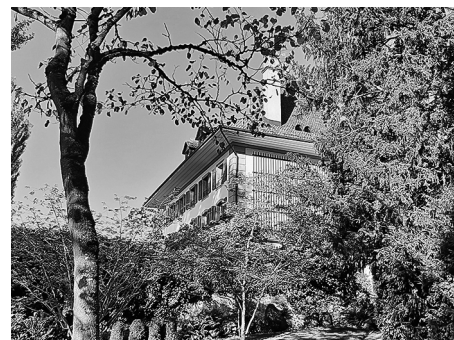
Law and Economics of Consumer Contracts and Privacy (online)

Lecturer: Florencia Marotta-Wurgler

Law and Economics of Liability and Enforcement for Corporations and Individuals (online)

Lecturer: Jennifer Arlen

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## AGENDA

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### CONFERENCES 2022

Research Days and Swiss Doctoral Workshop in Finance, jointly with Swiss Finance Institute  
European Summer Symposium in Economic Theory, ESSET, jointly with CEPR  
European Summer Symposium in Financial Markets, ESSFM, jointly with CEPR  
Conference with the Journal of Monetary Economics, jointly with the Swiss National Bank

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### CENTRAL BANKERS COURSES 2022

Inflation Forecasting and Monetary Policy  
External lecturers: Pierpaolo Benigno, Carlo Favero, Daniel Kaufmann, SNB staff  
Monetary Policy, Exchange Rates and Capital Flows  
External lecturers: Philippe Bacchetta, Giancarlo Corsetti, Philipp Harms, BIS and SNB staff  
Financial Stability  
External lecturers: Philippe Bacchetta, Michael Rockinger, Ernst-Ludwig von Thadden, SNB and Swiss Banking staff  
Money Markets, Liquidity, and Payment Systems  
External lecturers: Ricardo Lagos, Dirk Niepelt, Randall Wright, SNB staff  
Advanced Topics in Monetary Economics  
External lecturers: Lawrence Christiano, Stephanie Schmitt-Grohé, SNB staff  
Instruments of Financial Markets  
External lecturers: Philippe Bacchetta, Amit Goyal, Michel Habib, Erwan Morellec, Michael Rockinger, BIS and SNB staff

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### SWISS PROGRAM FOR BEGINNING DOCTORAL STUDENTS IN ECONOMICS 2021/22 AND 2022/23

Microeconomics  
Lecturers: Piero Gottardi, Johannes Hörner, John Moore, Klaus Schmidt  
Macroeconomics  
Lecturers: Fernando Alvarez, Jordi Galí, Sérgio Rebelo, Ricardo Reis  
Econometrics  
Lecturers: Bo Honoré, Mark Watson

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### ADVANCED COURSES IN ECONOMICS FOR DOCTORAL STUDENTS AND FACULTY MEMBERS 2022

An Introduction to Macro-Finance  
Lecturer: Atif Mian  
The Economics and Econometrics of Climate Change Policy  
Lecturer: James Stock  
Macro-Finance Modeling of Financial Intermediaries, jointly with the Swiss Finance Institute  
Lecturer: Arvind Krishnamurthy  
From Micro to Macro: Recent Advances in Economic Growth  
Lecturer: Ufuk Akcigit  
Bayesian Methods for Empirical Macroeconomics  
Lecturer: Gary Koop

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### LAW AND ECONOMICS COURSES FOR DOCTORAL STUDENTS AND FACULTY MEMBERS 2022

Law and Economics of Corporate Finance  
Lecturer: Holger Spamann  
Law and Machine Learning  
Lecturer: Eric Talley

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## PUBLICATIONS

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### Articles

**Nils Herger**, "Regulated Free Banking in Switzerland (1881–1907)", *Swiss Journal of Economics and Statistics*.

Nils Herger, "Unregulated and Regulated Free Banking: Evidence from the Case of Switzerland (1826–1907)", *Explorations in Economic History*.

Nils Herger, "Mr. Hayek and the Classics; A Suggested Interpretation of the Business Cycle Theory in 'Prices and Production'", *Quarterly Journal of Austrian Economics*.

Lucas Fuhrer and Nils Herger, "Real Interest Rates and Demographic Developments: The Role of Population Growth and Migration". *SUERF Policy Brief No.96*.

Simon Beyeler and **Sylvia Kaufmann**, "Reduced-Form Factor Augmented VAR – Exploiting Sparsity to Include Meaningful Factors", *Journal of Applied Econometrics*.

Andreas M. Fischer, Rafael P. Gremminger, Christian Grisse and Sylvia Kaufmann, "Portfolio Rebalancing in Times of Stress", *Journal of International Money and Finance*.

Toni Beutler, Matthias Gubler, Simona Hauri and Sylvia Kaufmann, "Bank Lending in Switzerland: Driven by Business Models and Exposed to Uncertainty", *International Review of Financial Analysis*.

**Cyril Monnet** and Erwan Quintin, "Optimal Exclusion", *AEJ-Microeconomics*.

Harris Dellas and **Dirk Niepelt**, "Austerity", *Economic Journal*.

Martín Gonzalez-Eiras and Dirk Niepelt, "The Political Economy of Early Covid-19 Interventions in US States", forthcoming in *Journal of Economic Dynamics and Control*.

### eBook

**Dirk Niepelt** (ed), *Central Bank Digital Currency: Considerations, Projects, Outlook*, CEPR Press, London.

### Contributions to Books

**Dirk Niepelt**, "Introduction", in: Dirk Niepelt (ed), *Central Bank Digital Currency: Considerations, Projects, Outlook*, CEPR Press, London.

Dirk Niepelt, "'Reserves for All: Political Rather Than Macroeconomic Risks'", in: Dirk Niepelt (ed), *Central Bank Digital Currency: Considerations, Projects, Outlook*, CEPR Press, London

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## DIRECTOR

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As of 1 April 2022, Martin Brown will be taking over as the Director of the Study Center Gerzensee. He succeeds Dirk Niepelt, who has held the position for the past 12 years. Dirk Niepelt is taking up a post as Full Professor of Macroeconomics at the University of Bern. The Governing Board of the Swiss National Bank and the Foundation Council of the Study Center would like to thank him for the outstanding achievements of the Center under his leadership. He has played a major role in building up the Study Center Gerzensee as a place of learning and a venue for academic research and dialogue, in preparing it to meet future challenges, and in bolstering its international presence.

In Martin Brown, the Study Center is gaining a Director who is a proven researcher and teacher. He completed his doctorate at the University of Zurich and is currently Full Professor of Banking at the University of St. Gallen. His research focuses on financial intermediation and household finance. With his academic record, management experience and extensive network in economics, Martin Brown is ideally suited to lead the Study Center in accordance with the wishes of its founder, to ensure the high quality of its activities, and to put it on the best possible footing to address the requirements of the future. The Governing Board and the Foundation Council congratulate Professor Brown on his appointment. (SNB press release, October 13, 2021.)

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## STAFF NEWS

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Among the teaching assistants, Milen Arro and Remo Taudien successfully completed the Swiss Program for Beginning Doctoral Students in Economics. Alexandra Piller, PhD student at the University of Bern, joined the Study Center as teaching assistant with the objective to complete her doctoral thesis.

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## FOUNDATION COUNCIL

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Dr. Fritz Zurbrugg  
Vice Chairman of the Governing Board of the Swiss National Bank

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ETH Zurich

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Dr. Attilio Zanetti  
Director of the Swiss National Bank  
Head of International Monetary Cooperation

Alexandre Zeller  
Managing Partner, Lombard Odier

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## WORKING PAPERS

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### 21.01

Raphael Auer, Cyril Monnet and Hyun Song Shin  
"Distributed Ledgers and the Governance of Money"

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## ABOUT

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[www.szgerzensee.ch](http://www.szgerzensee.ch)

Foundation of the Swiss National Bank

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