Discussion of “Credit Crises, Precautionary Savings, and the Liquidity Trap” by Veronica Guerrieri and Guido Lorenzoni

Discussion by Bob Hall

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Bewley model

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Realistic shocks
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Realistic shocks

No labor supply response
THE HOUSEHOLD STORY

Original distribution of liquid assets

Original consumption

Consumption with tighter credit

Liquid assets, thousands of $

Consumption, $1000s per month
THE MACRO STORY

Euler equation: \( \Delta \log c(W) = \sigma (r(W) - \rho) + g(W) \)
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But the zero lower bound may block that lower rate.
CASH FROM HOUSEHOLDS TO FINANCIAL INSTITUTIONS
SOMETHING TO CHECK

Compare cash from low-$W$ households in the model to these numbers.
DISTRIBUTION OF LIQUID ASSETS, SURVEY OF CONSUMER FINANCES
Distribution of liquid assets in GL model

behind the concavity of the consumption function and the convexity of the labor supply functions in Figure 1.

We are now ready to put the pieces together. Let us do a mental experiment and suppose the interest rate jumps immediately to its new steady state value at date 0. If the wealth distribution was already at the new steady state, average bond accumulation would be zero. In other words, the integral of the dashed function in the top panel weighted by the dashed density in the bottom panel is equal to zero. This implies that the integral of the dashed function weighted by the solid density is a positive number, because the dashed function is (approximately) convex and $F_0$ is a mean-preserving spread of $F_{00}$. Therefore, at the conjectured interest rate path, households want, on average, to accumulate bonds. Since the bond supply is fixed, this means that the conjectured interest rate path is not the equilibrium one, as it leads to an excess demand of bonds. To equilibrate the bonds market, we need a lower interest rate in the initial periods.

The non-convexity at very low levels of $b$ is due to the fact that at the new steady state, the labor supply for very low levels of $b$ is very high for the low shocks and in that region it is less elastic (given our preferences).
Explaining the tight dispersion of liquid wealth

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EXPLAINING THE TIGHT DISPERSION OF LIQUID WEALTH

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One explanation: Families have access to financial buffers apart from those reported in the SCF (Blundell, Pistaferri, and Preston AER 2008).

Another possibility: “Neither a borrower nor a lender be.” (Hamlet, Act 1, Scene 3). Families follow the advice of Polonius more enthusiastically than our DP models recommend.
Heterogeneity

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The SCF makes it pretty clear that we should allow for heterogeneity in permanent characteristics as well: productivity and time preference.
Traditional simplification of the ideas of the paper

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The rest are well buffered and follow the life-cycle-permanent income principle—they are on the flat part of the policy function.
Potential dichotomy from the SCF

Define a family as liquidity-constrained if its holdings of net liquid assets are less than two months of income.
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The fraction of households that were constrained—74 percent—is even higher because lower-income households are more likely to be constrained.
**ZLB issues**

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