

Discussion of

Supply and Demand in Disaggregated Keynesian Economies with an Application to the COVID-19 Crisis

by D. Baqaee and E. Farhi

A. Cesa-Bianchi *

Bank of England, CEPR, and CfM

Bank of Italy & CEPR Conference
Closing the Gaps: The Future of Stabilisation Policies After the COVID-19 Pandemic

Virtual meeting - June 18, 2021

*The views expressed here do not necessarily represent those of the Bank of England or of any of its Committees.

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- ▶ ... but does the AS-AD logic apply to multi-sector set ups?

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- ▶ Economics of supply and demand shocks are well-understood in one-sector models...
- ▶ ... but does the AS-AD logic apply to multi-sector set ups?
- ▶ **This paper** → Analytics of the transmission of sectoral shocks + Covid-19 application
 - * Multi-sector model with multiple factors, segmented labor markets, input-output linkages
 - * Downward nominal wage rigidities, credit constraints, and ZLB

This paper: Main takeaway



Quote Tweets



David Baqae @DB... · May 21, 2020 ...

Since every macroeconomist needs a Covid paper, here is one of mine. The most important thing I learned from the paper is that you really seem to need a negative aggregate demand shock to make sense of the data --- changes in the composition of demand/supply are not enough.



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- ▶ Negative sectoral shocks (both supply and demand) are stagflationary *Independent of complementarities*
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- ▶ Negative aggregate demand shocks are deflationary
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- ▶ Negative sectoral shocks (both supply and demand) are stagflationary *Independent of complementarities*
- ▶ Negative aggregate demand shocks are deflationary
- ▶ Sectoral shocks alone cannot make sense of both aggregate and sectoral data...
- ▶ ... while a combination of sectoral and aggregate shocks does

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 - * Two sectors, cinemas and popcorn
 - * Cinemas reduce capacity, their price increases
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 - * Two sectors, cinemas and popcorn
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- ▶ What am I missing? Under which conditions can we obtain deflationary recessions?
 - * Complementarity in consumption vs production?
 - * Heterogeneous price stickiness?

What do the data say?

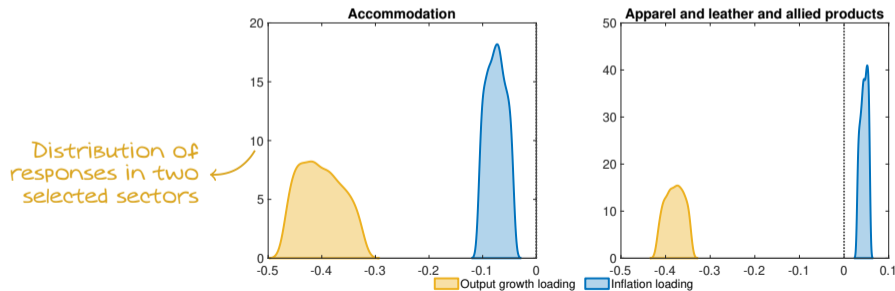
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- ▶ Empirical strategy (intuition)
 - * Identify an aggregate demand shock in VAR with aggregate data using sign restrictions
 - * For each 3-digit sector, estimate how output and prices respond to the shock (contractionary)

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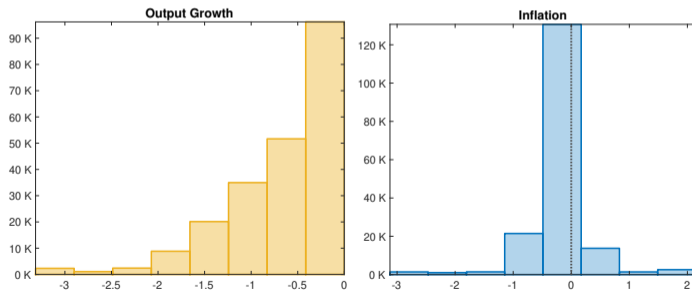
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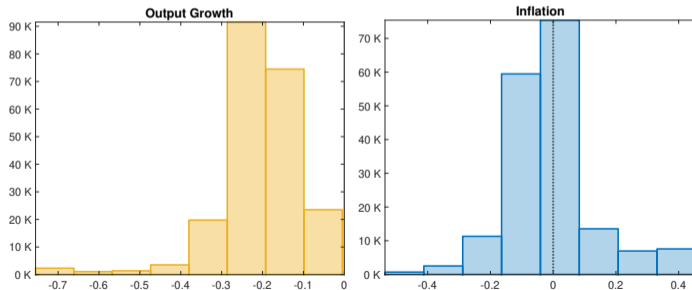
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Distribution of responses across all sectors



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- ▶ Data seem consistent with sectoral supply shocks driving deflationary recessions
 - * “The Transmission of Keynesian Supply Shocks,” joint with Andrea Ferrero
- ▶ Results corroborated by simulated data from multi-sector DSGE model with
 - * Asymmetric input-output linkages, heterogeneous price stickiness, complementarities
 - * Driven exclusively by sectoral TFP shocks



In sum

- ▶ Really exciting paper (and agenda), lots of results
- ▶ Highlights the role of sectoral and aggregate shocks to make sense of Covid-19 crisis
- ▶ Are supply-driven deflationary recessions possible? Under which conditions?
- ▶ Answer important for policy