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Portfolio Rebalancing and Consumption Response of Households to Monetary Policy Shocks

Sumit Agarwal, Yeow Hwee Chua, Pulak Ghosh and Changcheng Song

Discussion by

Naveen Gondhi

INSEAD and FTG

Main question

- The conventional wisdom is that looser monetary policy benefits households' consumption by reducing the cost of external finance.

- This paper exploits contractual frictions which limit the extent to which changes in monetary policy actually affect the cost of finance for households

  - **Main Channel:** When the terms of debt contracts are rigid (case of fixed rate term insurance products), changes in interest rates have heterogenous effects on consumption and investment decisions.

  - This paper exploits this variation.

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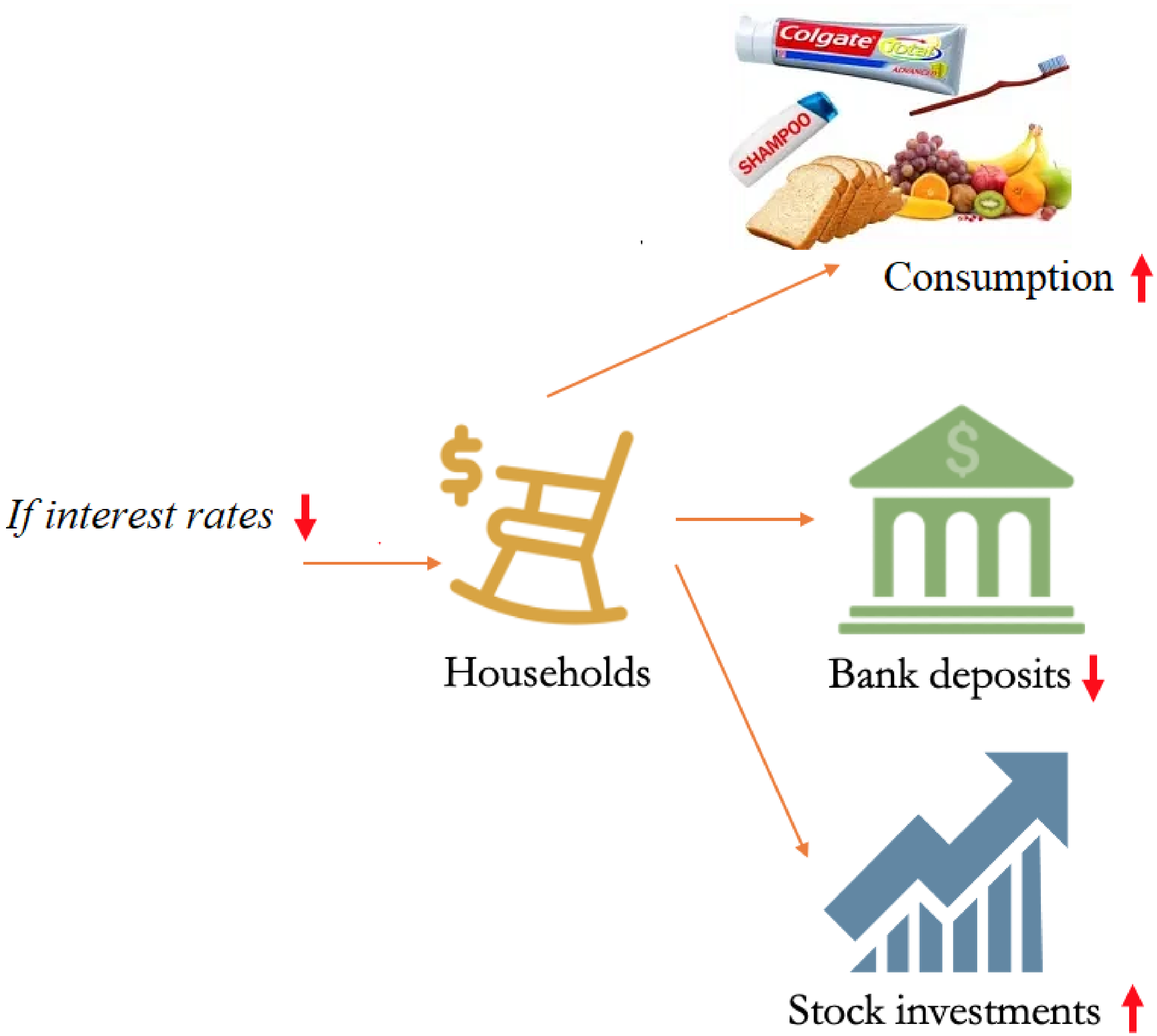
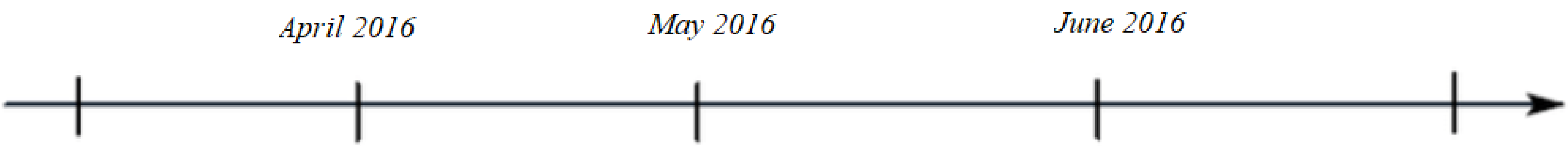
Main results



Identification



Fall in bank rate of 75bps

Treated: Depositors with expired time deposits in May 2016

Control: Expired time deposits in June, July, Aug 2016.... and households without expired term deposits

Comment 1

- Why should we care about this paper?
- To me, the interesting results are quantitative: interest elasticity of risky investment is 26 and the interest elasticity of consumption is -0.3.
- However, the authors are comparing households with immediate term deposit expiring vs the next few months. This implies that, the above quantities are relative and not absolute.
- If so, why should we care? And can we back out the absolute numbers using some back of the envelope calculations?

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Comment 2:

- Anticipation effect: If my term deposits are expiring in a month, will I wait for the expiration to change my consumption behavior?

- This is an empirical question.

- Suggestion: Use different control groups:
  - Expiring in 1-2 months
  - Expiring in 3-4 months
  - Expiring in more than 5 months

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Comment 3: Reaching for yield

$$x_i = \frac{\mu - r}{\gamma \sigma^2}$$

- Drechsler, Savov and Schnabl (JF 2017) argue that nominal interest rates and market risk-premium are positively correlated.

- Why are households purchasing zero beta assets?
- What is the return of this asset?

- Seems counterintuitive: If they are reaching for yield, shouldn't they buy high beta assets?

- Need more analysis here

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Comment 4: Reaching for yield?

For each 100 rupees that have expired in term deposits,

- 22 rupees go towards renewal of term deposits,
- 40 rupees are transferred to their savings account.
- 16 rupees are allocated towards risky investments and 3 rupees used for insurance premium.
- In terms of spending, 1 rupee is allocated for consumption, while 3 rupees towards loan repayments.

- Quantitively, Does this makes sense?

- Why would a rational agent do this?

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Conclusion

- This paper: Monetary policy transmission mechanisms
- A very clearly written paper: provocative and a pleasure to read
- Think more about why we should care and the quantitive magnitudes
  - Above comments are largely targeted towards this