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Macro Roundup Article

Headline: Government Debt in Mature Economies. Safe or Risky?

Article Link: https://www.kansascityfed.org/Jackson%20Hole/documents/10341/Hanno_Lustig_Paper_JH.pdf

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Publication	Federal Reserve Bank of Kansas City
Publication Date	August 26, 2024

Tweet: .@HannoLustig and @rgomezcram argue the pandemic was a period of "fiscal dominance" in which bondholders insulated taxpayers from increased spending by absorbing capital losses. From March 2020 to March 2022, the government's real debt fell by 10%.

Summary: Governments and central banks can protect either taxpayers or bondholders from government spending shocks. When they choose to insulate taxpayers, government bond yields increase in response to unfunded fiscal expansions as the government debt is marked to market. The risks of unfunded spending shocks are then borne by bondholders. This risky debt regime is a better fit for recent experience. High-frequency evidence from the COVID episode links U.S. In Figure 12, the cumulative change in the Treasury portfolio valuation on large negative proposal days [in red] exhibits a smooth downward trend over the extended sample, implying that the effects are attributed to a consistent flow of fiscal news rather than a few large observations. Between March 2020 and March 2022, the effect is much larger, as shown by the significant steepening of the red line. During COVID the overall value changes shown by the blue line were primarily driven by fiscal news. [Finally], in this risky debt regime, large-scale asset purchases in response to large government spending provide temporary price support to government bonds, a net loss for taxpayers.

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Primary Topic: Fiscal Deficits

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