

Discussion of
"Should Monetary and Fiscal Policy Pull in the Same Direction"
by Drago Bergholt et al.

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Summary of main points

- Bergholt *et al.* use a fairly standard NK DSGE model of a small open economy to study the optimal mix of fiscal and monetary policy.
- Main insight: Depending on the nature of the shock to the economy, it may be optimal for monetary and fiscal policy to **NOT** pull in the same direction.
 - E.g., after a domestic cost-push shock, optimal mix entails **contractionary** monetary policy (MP) and **expansionary** fiscal policy (FP).
- On first impression, the main finding may appear surprising and in contrast with quoted recommendations by OECD and IMF.
 - However, these recommendations come from a world with policy constraints! Which may overturn the results. Be careful not to "oversell" this discrepancy.

Generality of the main result (I)

- Let's first consider the necessary requirements for FP and MP to both play a role. In the context of this paper, I believe these are:
 1. FP and MP have different **sacrifice ratios**
 - Achieved via different effects on the exchange rate.
 2. Some deviation from the "divine coincidence", i.e., policy tradeoffs are needed.
 - Achieved via imperfect exchange rate pass-through (and endogenous risk premium).
- In this light, the result is perhaps not so surprising.
 - MP and FP should both be used according to their comparative advantage.

Generality of the main result (II)

- In fact, in this light, it seems surprising that MP and FP should **ever** pull in the same direction in this model!
 - Why not *always* exploit comparative advantages?
- The counterexample in the paper is given by demand shocks, where FP and MP should pull in the same direction.
- **Why?** What's so special about demand shocks in this context?
- Is it how the shock enters the economy? Both the demand and risk premium shocks will enter through the dynamic IS curve...
- Explaining this clearly would help the reader to grasp the generality of the main result.

The role of the real exchange rate

- The authors state that a key difference between MP and FP is that only the former has a *direct* effect on the real exchange rate, while the latter only has an *indirect* effect.
- To some extent semantics, but: In equilibrium, FP also affects the exchange rate.
 - Many have studied this response empirically and proposed theoretical mechanisms to account for it (e.g., Ravn *et al.*, 2012; Ferrara *et al.*, 2021).
- Would be helpful if the authors focus on the fact that MP and FP push the exchange rate in *different directions*.
- Showing this via IRFs would allow the reader to assess the empirical implications of the model: Are the responses of the exchange rate to FP and MP (and the difference between them) credible from a quantitative viewpoint?

Opening Pandora's Box: Disaggregated effects

- The authors focus on *aggregate* differences in the effects of MP and FP.
- One interesting extension could be to consider a two-sector model with tradeable and non-tradeable goods.
- Would allow to study the “sectoral sacrifice ratio”; or how much each of the policies can stimulate one sector relative to the other.
 - By depreciating the real exchange rate, a monetary expansion is likely better suited to stimulate the tradeable sector, while FP is (at least relatively) more effective at stimulating the non-traded sector (especially if government spending is home biased).
 - Druedahl *et al.* (2024) consider this in a HANK context, but do not study optimal policy.

Smaller points to consider

- **Generality, again:** Less-than-perfect exchange rate pass-through is needed. So would your results hold under DCP?
- **Is “optimal” really optimal?** The authors consider policies that minimize a stated loss function, not a micro-founded, welfare-based one. Would be reassuring to confirm that the insights hold up in such a setting.
- **Why all the bells and whistles?** Ingredients such as indexation, habits, sticky wages AND prices are usually used for fitting the data – not clear why they are needed here.
- **ZLB as adjustment cost?** Section 5 considers adjustment costs in the real interest rate – why not the nominal rate? This matters at the ZLB: obvious example of “adjustment cost” of the nominal rate; but the real rate can adjust at ZLB!. Should be clarified.

References

- Druedahl, J., S.H. Ravn, L. Sunder-Plassmann, J.M. Sundram, and N. Waldstrøm, 2024, The Transmission of Foreign Demand Shocks, working paper.
- Ferrara, L., L. Metelli, F. Natoli, and D. Siena, 2021, Questioning the Puzzle: Fiscal Policy, Real Exchange Rate and Inflation, *Journal of International Economics* 133, 103524.
- Ravn, M.O., S. Schmitt-Grohé, and M. Uribe, 2012, Consumption, Government Spending, and the Real Exchange Rate, *Journal of Monetary Economics* 59, 215-234.