Buraschi-Jiltsov: „Term Structure of Interest Rates Implications of Habit Persistence“

Comments by

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This is an impressive paper,

- linking the habit persistence models of real asset pricing to monetary economics,
- and testing the restrictions of the structural model with long time-series of U.S. interest rates, inflation rates, and money supply.

The achievement: transpose the findings of the „real“ literature (Campbell-Cochrane, 1999) to monetary variables.

And the paper is forthcoming in the *Journal of Finance*.

What else can be done?

The paper builds on several basic assumptions:

- Representative agent
- Exchange economy
- Transactions demand for money

Which ones are crucial?

Representative Agent:

Intuitively, heterogeneity in endowments should induce persistently different consumption trajectories (under non-separable time-preferences) if markets are not dynamically complete. How reliable can the model predictions be if markets are incomplete?

In a representative-agent economy, H(t) measures both, aggregate fads and individual consumption experience. Can one disentangle the two?

Exchange Economy:

Without production, savings are simply determined by individual preferences and the exogenous endowment process. Is it empically plausible to compress all supply-side changes (productivity, globalization, …) into the endowment process?

Can this simplification be the reason for the weak performance of the model in the estimation of the moments of the real short-term yield?

Money Demand:

The model uses a very reduced form of transactions demand for money (equivalent to cash-in-advance). This creates a direct channel from monetary policy today (via consumption demand today and habit persistence) to consumption tomorrow and thus money demand tomorrow.

This generates very nicely the empirically observed correlation between money growth and (nominal) interest rates.

But what about other motives for money holding, in particular precautionary money demand?

Money Supply

In the model, money supply is exogenous. How realistic is this assumption (despite Stock-Watson)?

Note: Monetary policy is not neutral in this model.

Habit persistence:

It seems that habit persistence is sufficient to generate realistic restrictions on interest rates and consumption.

Is it also necessary?

What are the comparative statics of the degree of habit persistence?

Without habit persistence, are we back to Marshall (JoF 1992)?