

Discussion of:  
**'The Labor Demand and Labor Supply Channels of  
Monetary Policy'**  
by S. Graves, C. Huckfeldt, E. Swanson

Vivien Lewis (Deutsche Bundesbank)

28<sup>th</sup> November 2024  
ECB Conference on Macroeconomic Modelling

The views expressed here are the discussant's and do not necessarily reflect those of Deutsche Bundesbank.

## Paper summary

Question: How does monetary policy (MP) affect the labor market?

- Traditionally, MP assumed to affect only labor **demand**,  $L^d$
- This paper instead identifies effects on labor **supply**,  $L^s$

Contribution: identification of supply-driven labor flows

- Search behavior chosen by worker; **U $\rightleftharpoons$ N flows** are supply-driven
- Decomposition of E $\rightarrow$ N flows into quits and layoffs; **E $\rightarrow$ N quits** are supply-driven

Result: Contractionary MP shock reduces E $\rightarrow$ N quits, increases N $\rightarrow$ U flows

- Non-participation becomes less attractive in recession  $\Rightarrow$  '**activation effect**' of MP
- Countercyclical  $L^s$  responses **dampen employment** responses to MP shocks

# Overview of comments

## Assessment

- Great work. Very interesting and intriguing results!

## Questions and comments

- ① What determines non-participation over the cycle?
- ② (When) is there an 'activation effect' of MP?

# What determines non-participation over the cycle?

Procyclical utility values of being in E, U or N (?)

- ✗ Disutility of working and disutility of searching keeps people out of E and U, resp.
- ✗ Utility of leisure (=value of not working or searching) keeps people in N

**Wage channel:** wages ↓ in recessions

- ✗ Substitution effect (SE): substitute away from work ⇒ search ↓, E→N quits ↑
- ✓ Income effect (IE): lower demand for leisure ⇒ search ↑, E→N quits ↓

**Wealth channel:** asset values ↓ in recessions

- ✓ Wealth effect (WE): lower demand for leisure ⇒ search ↑, E→N quits ↓

**Precautionary  $L^S$  channel:** cyclical transition rates (Hobijn and Şahin, 2021)

- ✗ ✓ Job finding rate ↓ ⇒ lower return to searching ⇒ search ↓, E outflows ↓
- ✓ Spouse's job loss prob. ↑ ⇒ spousal insurance ⇒ search ↑, E→N quits ↓

## (When) is there an 'activation effect' of MP?

How do your findings square with these stylized facts:

- Aggregate participation rate not very cyclical (Mankart and Oikonomou, 2016)?
- Widespread E→E transitions (Fujita et al., 2024) ⇒ Mismeasurement of E→N quits?
- DNWR implies small wage response to MP shocks (Daly and Hobijn, 2014)
- Added worker effect ⇒ Do we need a dual-earner HANK model (Bardóczy, 2022)?

Is activation effect (likely) confined to US?

- Employment adjustment costs, e.g. EPL, imply small labor flows overall
- Generous u/e benefits imply non-participation much less attractive

Do we really need a HANK model?

- How does representative agent model fail to produce an activation effect of MP?

## References I

- Bardóczy, B. (2022). Spousal Insurance and the Amplification of Business Cycles. Technical report, Federal Reserve Board of Governors.
- Daly, M. C. and Hobijn, B. (2014). Downward Nominal Wage Rigidities Bend the Phillips Curve. *Journal of Money, Credit and Banking*, 46(S2):51–93.
- Fujita, S., Moscarini, G., and Postel-Vinay, F. (2024). Measuring employer-to-employer reallocation. *American Economic Journal: Macroeconomics*, 16(3):1–51.
- Hobijn, B. and Şahin, A. (2021). Maximum employment and the participation cycle. Working Paper 29222, National Bureau of Economic Research.
- Mankart, J. and Oikonomou, R. (2016). Household search and the aggregate labour market. *The Review of Economic Studies*, 84(4):1735–1788.