



Research Working Papers

Unconventional Monetary Policy and Local Fiscal Policy

by: Huixin Bi and Nora Traum

November 07, 2022

Central bank municipal bond purchases increase private investment but have muted effects on state and local government spending.

RWP 22-15, November 2022

Following the onset of the pandemic, in a novel program the Federal Reserve directly intervened in municipal bond markets. We characterize the fiscal and macroeconomic implications of such central bank actions in a New Keynesian model of a monetary union. We assume that state and local governments are subject to a loan-in-advance constraint, to capture the observation that with lumpy cash flows, they often finance a fraction of expenditures by issuing short-term bonds. This municipal debt is held by financial intermediaries, who also supply credit to the private sector. Direct central bank purchases can transmit to the economy through two main channels: 1) by alleviating cash flow problems of the regional governments and 2) by accelerating lending in the economy if credit constraints ease more broadly. We quantify the importance of these channels and show that the transmission of the Federal Reserve's intervention is markedly different from direct federal government aid through intergovernmental transfers. Importantly, action by the central bank leads to more sizeable increases in private investment but has more muted effects on state and local government expenditures.

Article Citations

- Bi, Huixin, and Nora Traum. 2022. "Unconventional Monetary Policy and Local Fiscal Policy." Federal Reserve Bank of Kansas City, Research Working Paper no. 22-15, October. Available at <https://doi.org/10.18651/RWP2022-15>
-

Author



Huixin Bi

Research and Policy Officer

Huixin Bi is a Research and Policy Officer in the Economic Research Department of the Federal Reserve Bank of Kansas City. Previously, Ms. Bi served as an economist at the Bank of Canada from 2010 to 2015. Her main areas of research are fiscal policy, sovereign debt and computational economics. She holds a B.S. in engineering from Nankai University in China, a M.S. in engineering at Rose-Hulman Institute of Technology, and a Ph.D. in economics from Indiana University.
