Monetary-Fiscal Interactions in the United States

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Abstract :
How does the fiscal side of the US government respond to monetary policy, and does it matter? We estimate the response of fiscal variables to monetary shocks and the counterfactual response of macroeconomic aggregates to those shocks under different fiscal rules. Following an interest rate hike, the fiscal authority does not react: spending and transfers remain constant, tax receipts fall along with output, and interest payments and debt increase. Monetary policy would be more contractionary if fiscal policy stabilized debt through spending or taxes, but less contractionary if it used transfers. Indeed, transfer hikes reduce real debt by raising inflation.