

Q: Risk, Rents, or Growth?

Corhay, Kung & Schmid

Discussion – Mitsui June 2019

Erik Loualiche

Motivation

Accounting for the Rise in Asset Valuations

- Document an increase in Q
- Document other concurrent macroeconomic trends
- “Valuation accounting”:

$$\Delta Q = \Delta \text{labor share} + \dots$$

Leading (hopeful) candidates

- 1 Fall in interest rate: risk premium or risk free rate
- 2 Change in expectations
- 3 Change in the structure of the economy:
 - ▶ fall in the labor share
 - ▶ rise in intangibles
 - ▶ rise of market power

Discussion

Looking at macroeconomic trends

- Are increase in valuations the most puzzling aspect of the recent macroeconomy?
- A look at investment, risk premia...

Reconciling the facts: naive approach

- Looking at first order conditions for capital

Structural Approach

- This paper
- What are the challenges to a correct interpretation

Plan

1 Some recent trends of the macroeconomy

2 The Naive Approach

3 Identification

Tobin's Q

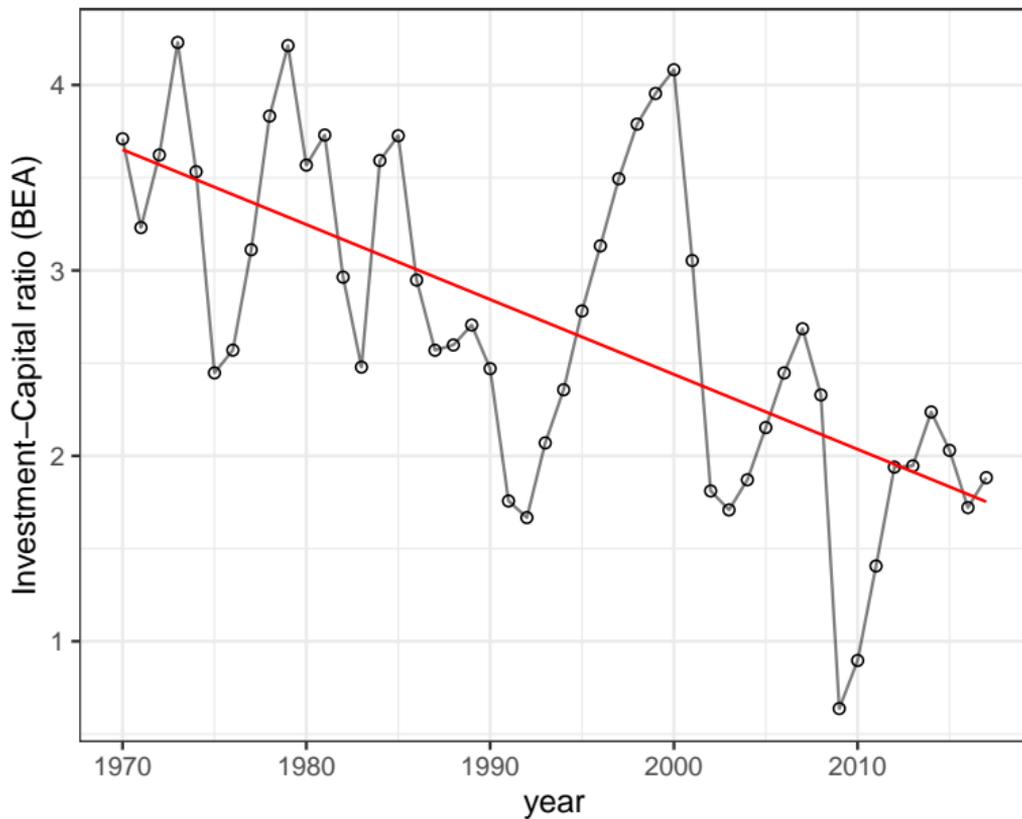
Increase in Q

- Value of newly created unit of installed capital has increased:
 - 1984-2000: 1.15
 - 2001-2016: 1.26

Tobin's Q



Investment



Investment

Decline in Investment

- Real puzzle: disjoint trend in valuations and investment...
- If valuations are **high** ... investment is really **low**

Narrowing the set of candidates

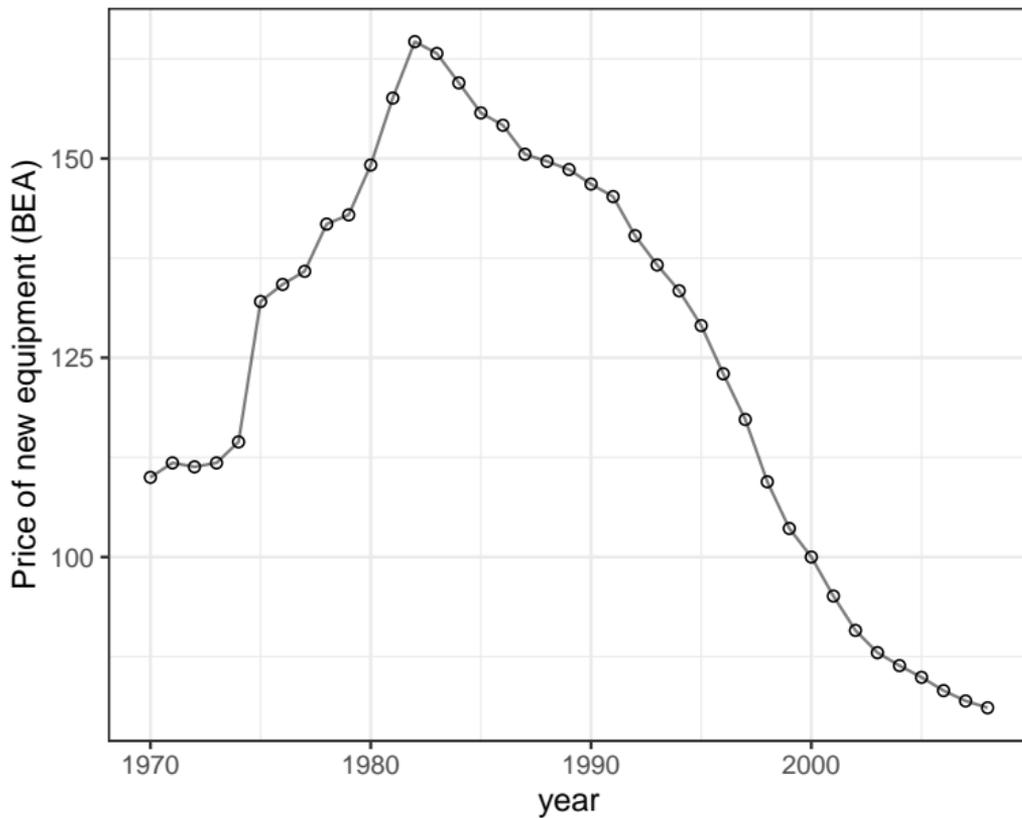
Expectations

- Suggests joint movement in both investment and prices: NO

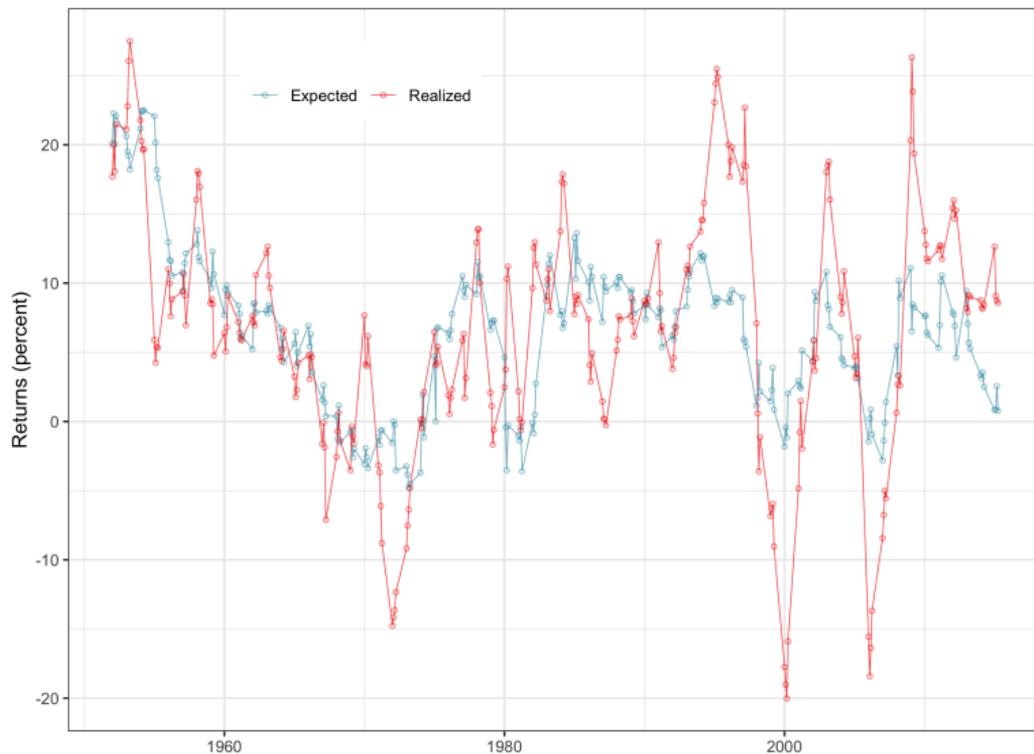
Price of investment goods

- Similar argument ...

Narrowing the set of candidates



Narrowing the set of candidates: Risk Premia



Narrowing the set of candidates

Changes in Organization of the Economy

- Labor share
- Markups
- Intangibles
- Globalization ...

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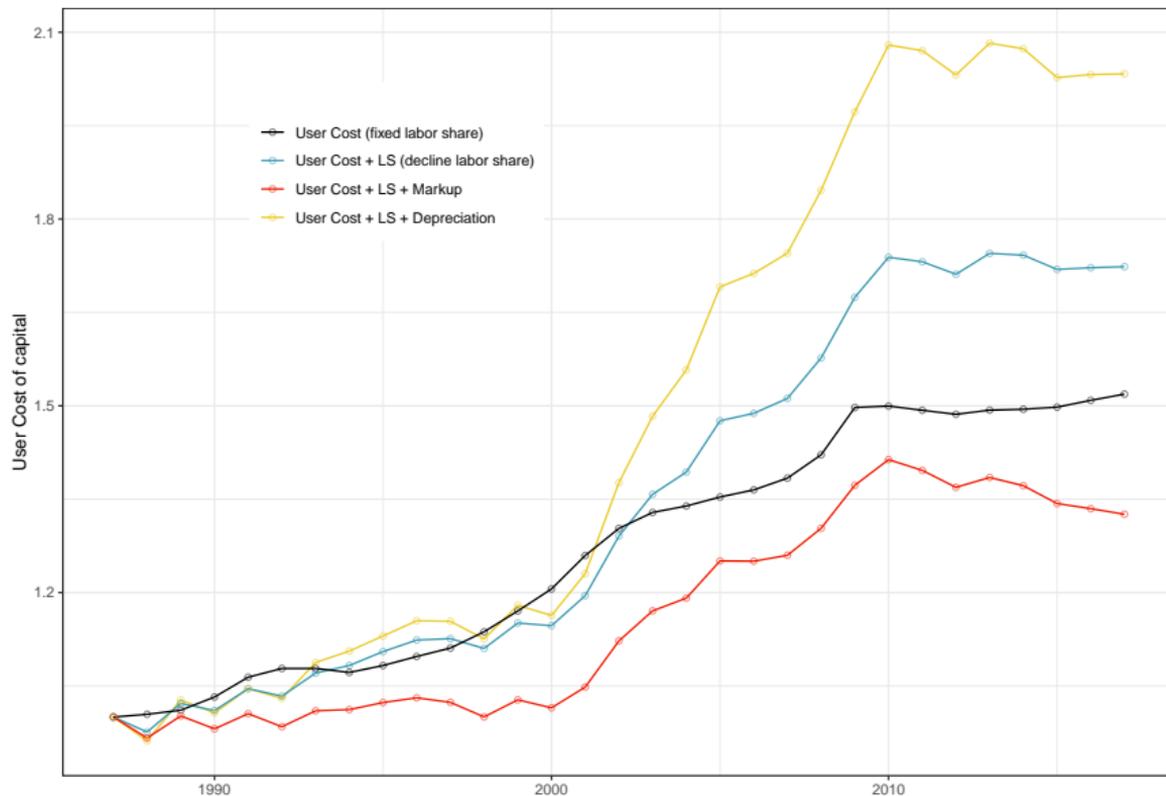
Capital First Order Condition

Demand for Capital

$$A \cdot (1 - \alpha) \left(\frac{l}{k} \right)^\alpha \cdot \frac{1}{\mu} = r_f + rp + \delta$$

- Simple analysis of the main forces behind low demand for capital
- Accounting from all the different sources in the equation

Capital First Order Condition



Issues with this approach

Endogeneity!

- Markups are related to risk premia ... CKS, Hou & Robinson, Loualiche
- Same for labor share: affects aggregate consumption

Solution I

- Reduced form estimated using the cross section
- Find an instrument: exogenous shock to the labor share or markups

Solution II (this paper)

- Specify microfounded relation between variables: structural model
- Estimate relevant moments from the data Find an instrument: exogenous shock to the labor share or markups

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How does this paper solve it?

Pick a few parameters

- Easier said than done: it is hard to decide what the model should focus on
- Find moments (trends) for these parameters (of course not 1:1)
 - ▶ β : risk free rate
 - ▶ κ entry cost: markups
 - ▶ δ depreciation and a productivity: output growth
 - ▶ γ price of risk: P/E ratios
 - ▶ η intangibles:

Better motivation

- Authors are briefs on motivation of choices of moments
- Nothing on the falling labor share (change of production structure that could be modelled)

Main Results

Importance of Competition

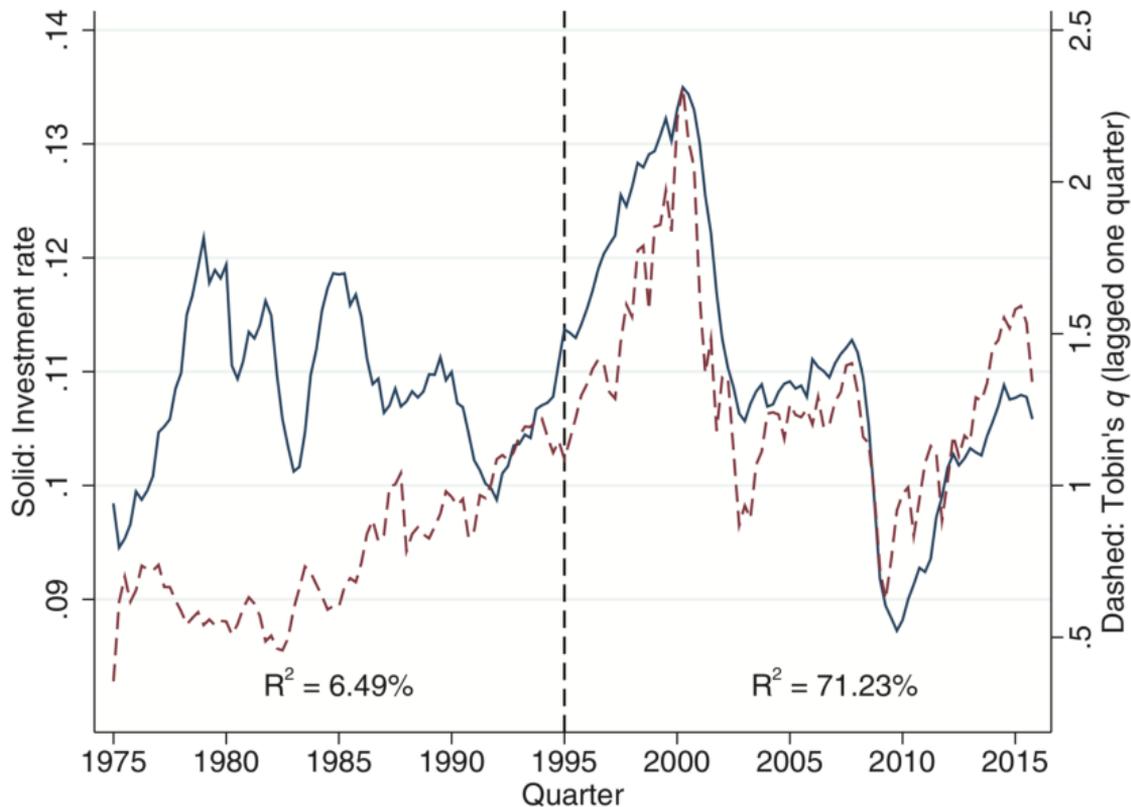
- Competition makes environment more risky: cannot separate one from the other
- How to get high valuations with high risk premia → **low risk free rate**

Some shortcomings (overidentifying restrictions)

$$\text{MPK} = A \cdot (1 - \alpha) \left(\frac{l}{k} \right)^\alpha \cdot \frac{1}{\mu}$$

- Low investment with low user cost of capital
- Model → **low productivity** A
- Similar intuition regarding the labor share ...

Final Thoughts: Mann, Moyen, and Andrei



Final Thoughts

Results

- Great paper!
- Strong structural interpretation

Some shortcomings

- Needs a reinterpretation of some of highlighted trends