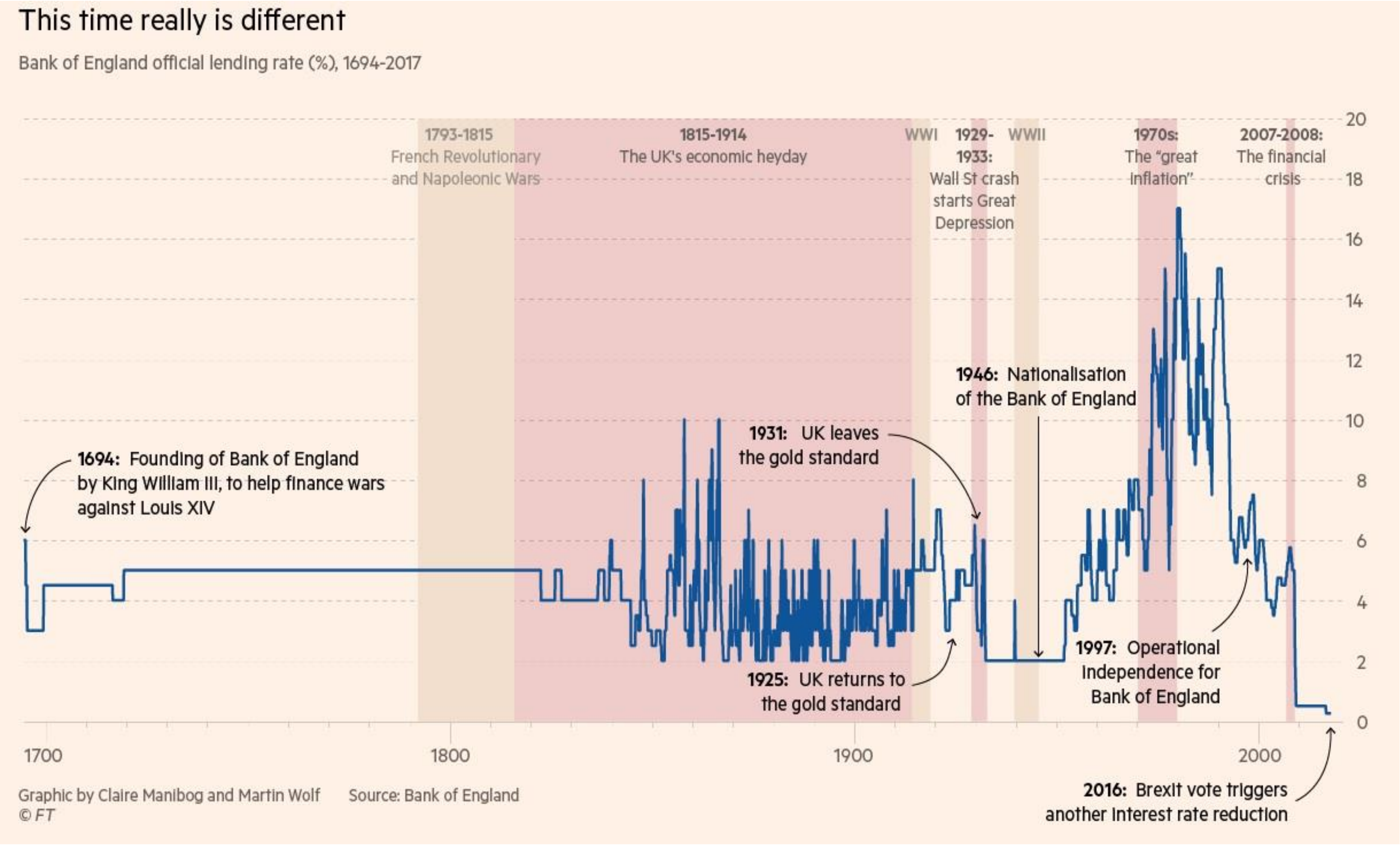
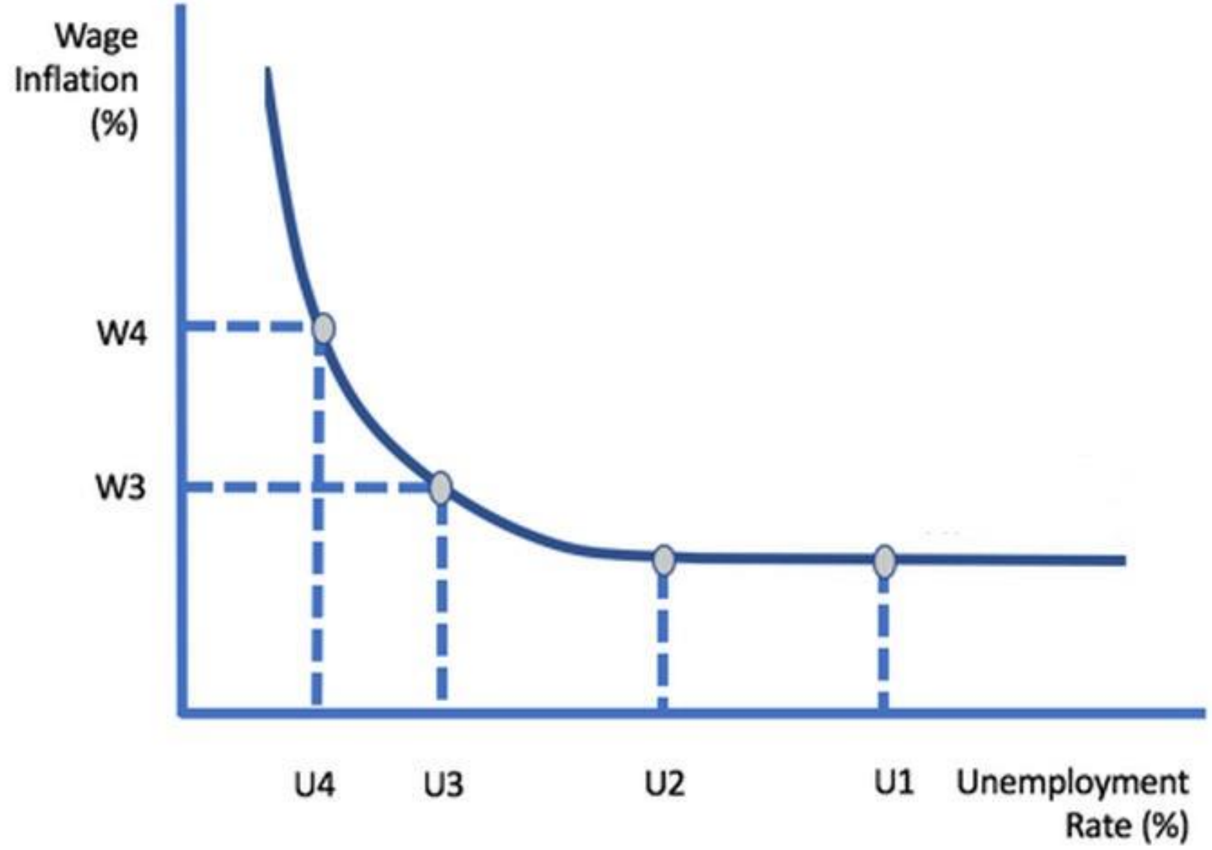
Class 2 – 2021-2022

Martin Wolf: "Nothing like this has happened in 323 years", *The Financial Times*, August 16, 2017



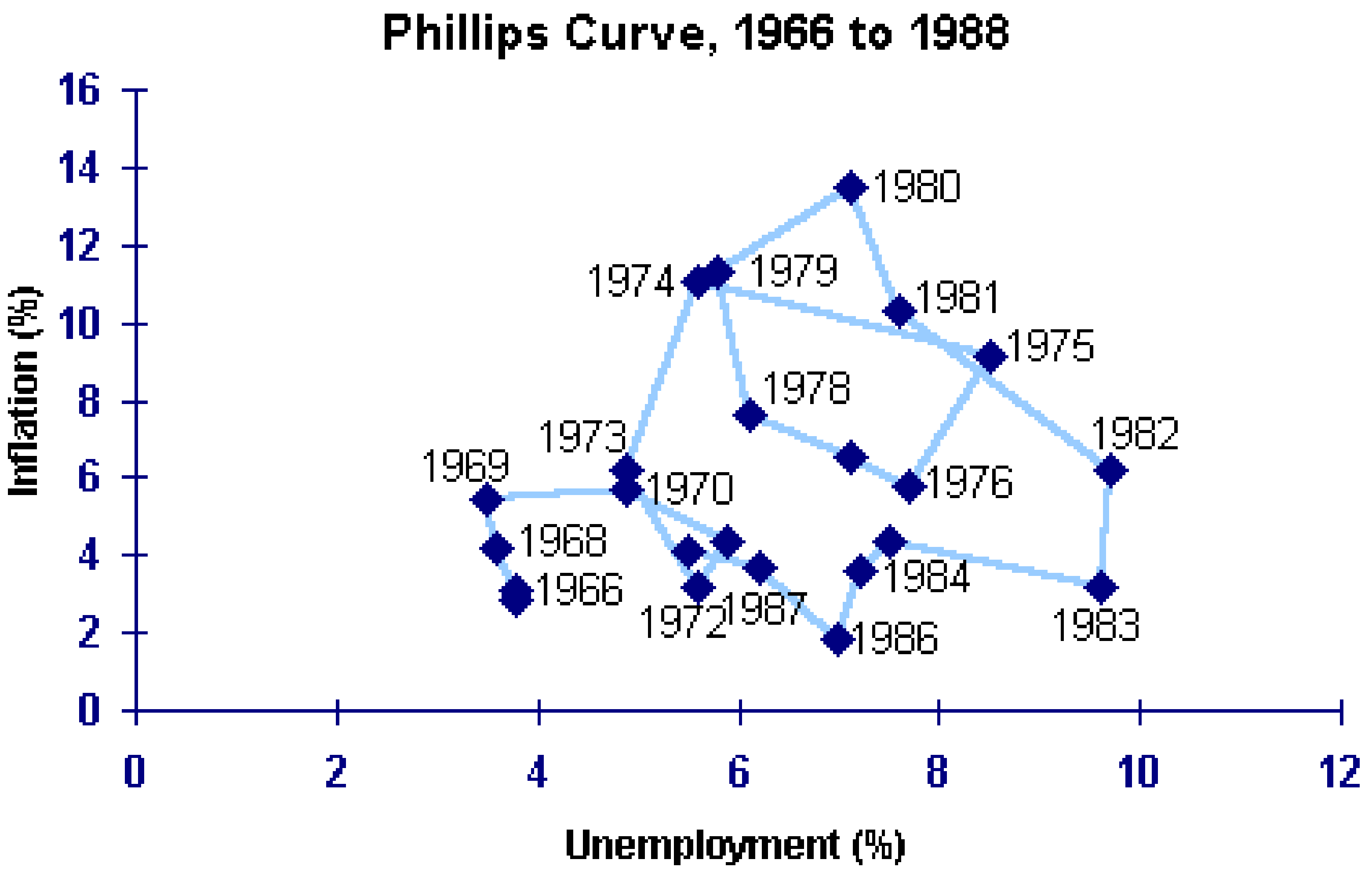
The Good Old Days ☺

The basic model



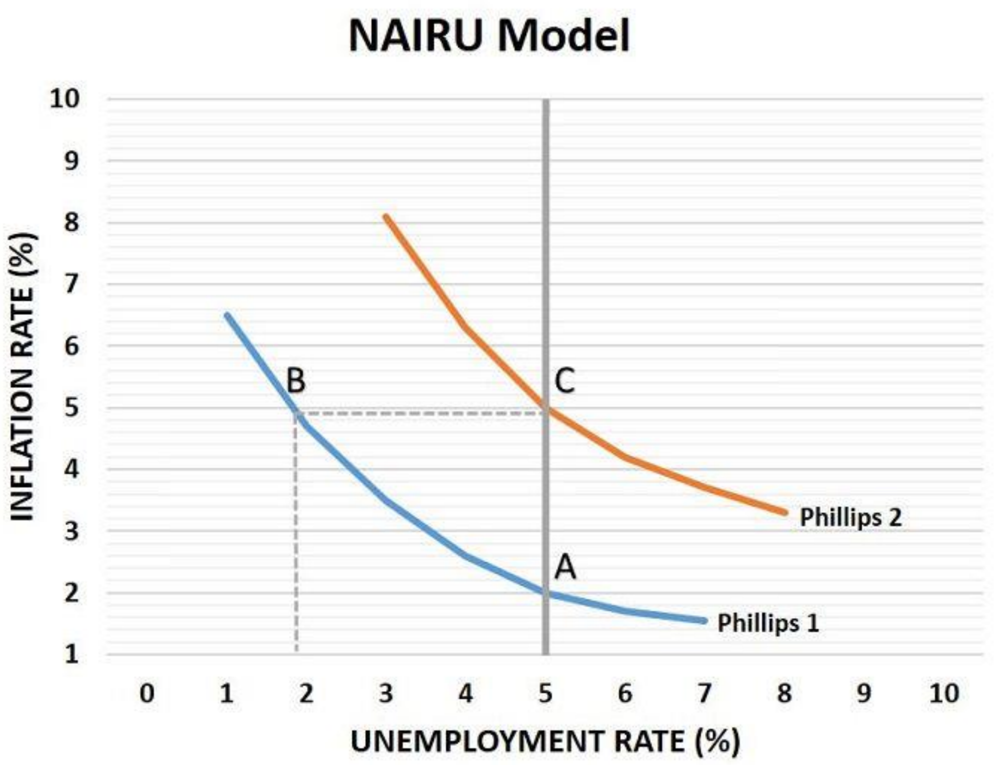
Fiat money - 1971

And then... ☹



Phillips Curve, 1966 to 1988
Inflation (%)
Unemployment (%)
0
2
4
6
8
10
12
14
16
0
2
4
6
8
10
12
1980
1974
1979
1981
1975
1978
1973
1982
1969
1970
1976
1968
1966
1984
1972
1987
1986
1983

A New World



$$MV = PT$$

Federal Funds Rate

The long road to Jackson Hole

A lesson from the Kiwis - 1990

Eric Isselee

Direct inflation targeting!

No intermediate targets

(no more M0, M3, etc., or currency pegs)

Taylor Rule (1992)

$$i_t = \pi_t + r_t^* + a_\pi(\pi_t - \pi_t^*) + a_y(y_t - \bar{y}_t).$$

i_t = target short term nominal interest rate (FFR)
r*t = assumed equilibrium real interest rate (i.e. output and demand in balance and prices are stable)
Πt = rate of inflation (GDF deflator)
Π*t = the desired rate of inflation (usually 2%)
yt = logarithm of real GDP
$\bar{y}$t = logarithm of potential output

The Jackson Hole consensus (during the “Great Moderation”: mid-1980s to GFC)

- Independent central banks, and policy managed by expert committees;
- Direct inflation targeting (no intermediate targets like the money supply);
- Short term interest rates (Federal funds rate) as the instrument to meet this target (in conformity with “Tinbergen’s Rule” that the number of targets ;
- Policy for setting rates was forward-looking, given the time lags of “monetary channels”;
- To be credible and enforce expectations, policy has to be transparent and communicated clearly to markets.

Robert Lucas – January 2003

"My thesis in this lecture is that macroeconomics in this original sense has succeeded: Its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades."

The Brave New World (late 2008)

- Ultra-low interest rates

- QE

- Forward guidance

- Even a clear unemployment target


FRED
10-Year Treasury Constant Maturity Rate
2-Year Treasury Constant Maturity Rate
3-Month Treasury Bill: Secondary Market Rate
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
Percent
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
2020
Shaded areas indicate U.S. recessions
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

The rise… and rise of Federal Reservce assets

NEW YORK TIMES BESTSELLER

"The one economics book you must read now ... If you want to understand this bifurcated world and where it's headed, there is no better interpreter than Mohamed El-Erian." *TIME*

MOHAMED A. EL-ERIAN

With a new Introduction by the author

THE ONLY GAME IN TOWN

CENTRAL BANKS, INSTABILITY, *AND* AVOIDING THE NEXT COLLAPSE

Secular Stagnation – Lawrence Summers

- Increasing propensity to save
- Real natural (neutral) interest rates (Wicksell) are too low to be achieved by conventional monetary policy (at the lower bound)
- Savings > asset price inflation (M&A, private equity buyouts)
- Inequality, uncertainty over pensions > saving
- New Economy companies awash with capital, and traditional investment opportunities reduced

Secular Stagnation – Lawrence Summers

- Reinhart & Rogoff: debt pile-up
- Robert Gordon: declining productivity
- Bernanke: continuation of “global savings glut”
- Krugman: old style liquidity trap
- Conclusions:
  - Constraint is on the demand side
  - Competitive monetary easing > currency wars
  - Coordinated fiscal expansion

2019 New Thinking on Inflation and fiscal policy

At the Fed:

- Extensive review of low-inflation environment
- “Fed listens” > town hall consultations
- Toleration of above target inflation to compensate for years of below-target inflation

- O. Blanchard (presidential address of AEA, 2019):

  Long term (real) interest rates on govt debt tend to be less than rate of growth > greater sustainability of govt. deficits and debt…?