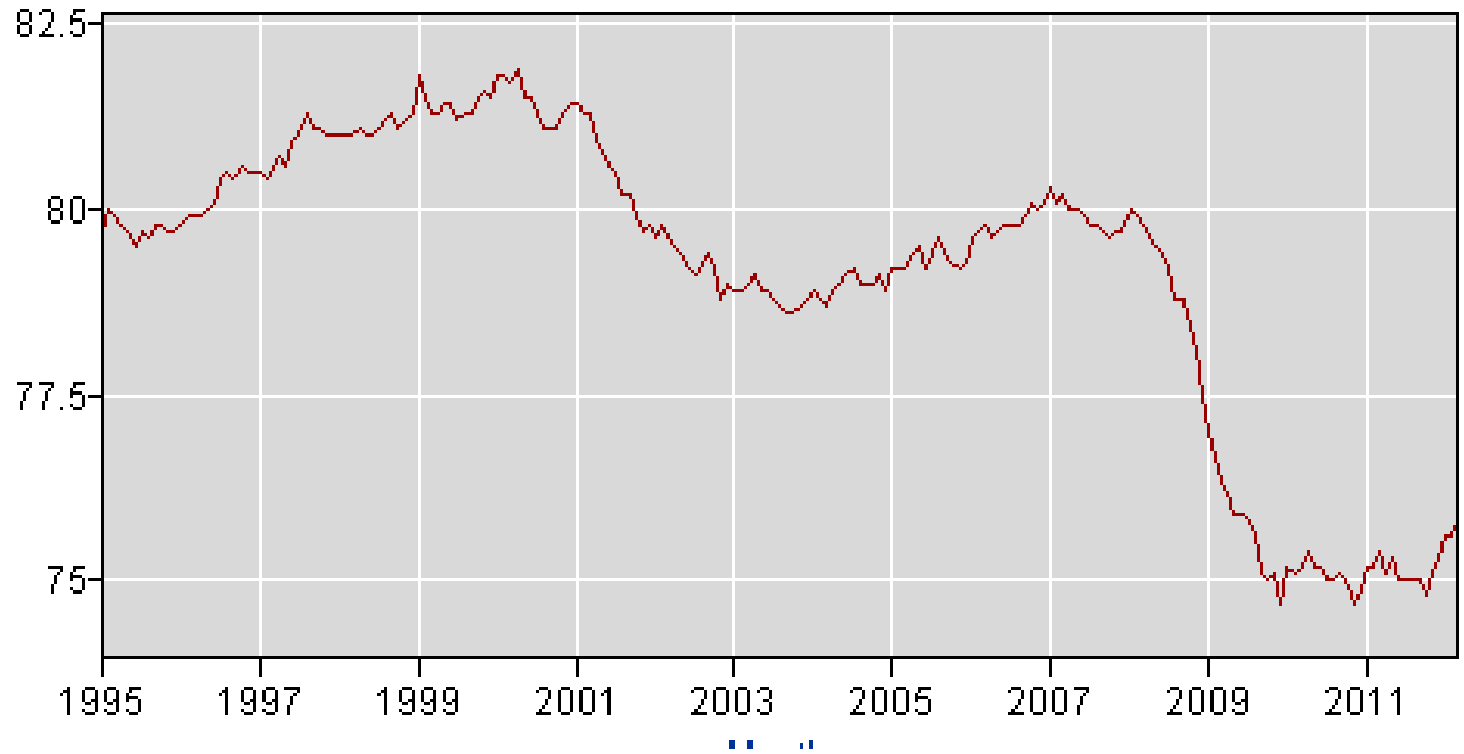


Year Five of the Slump: What Have We Learned?

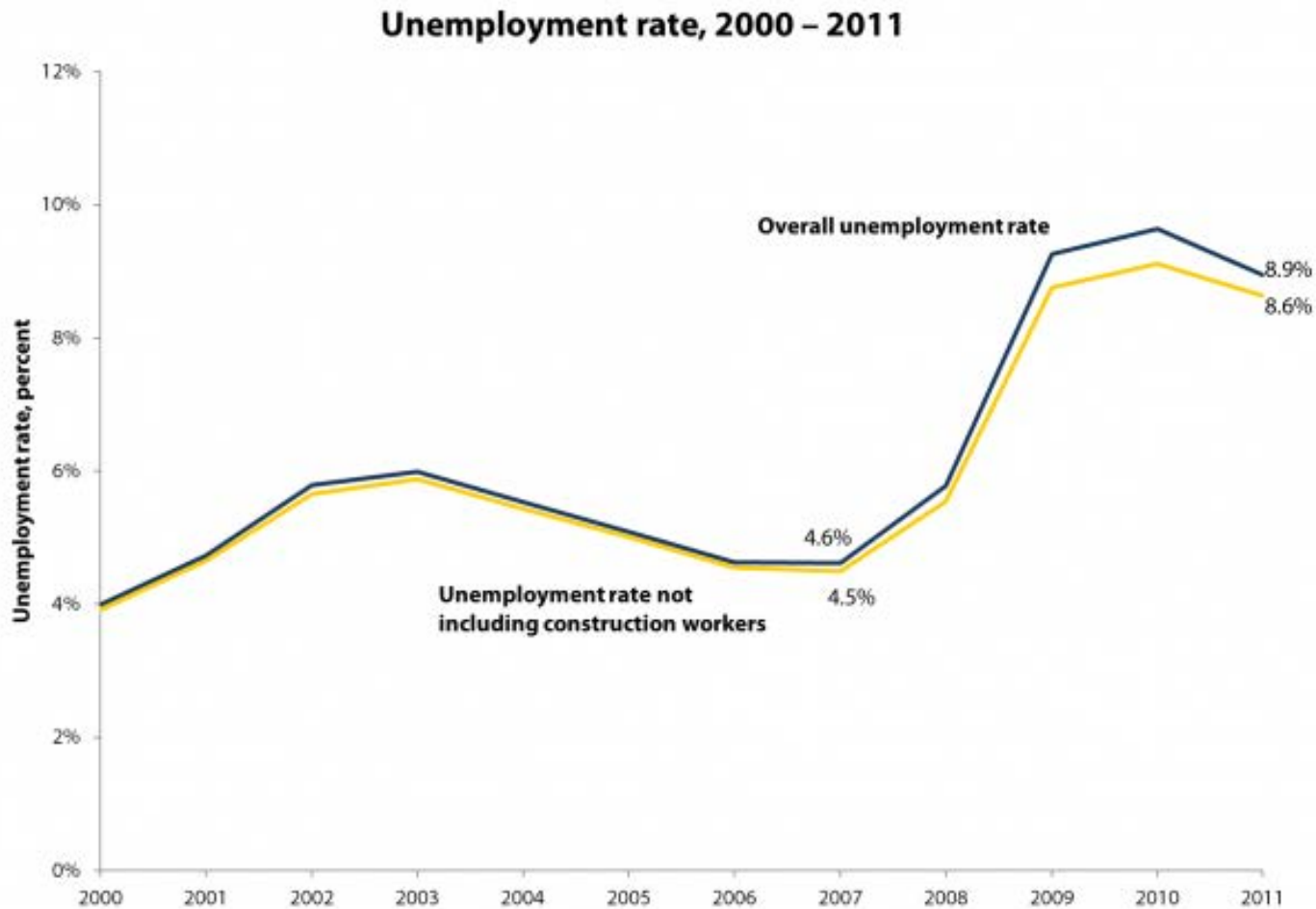
Paul Krugman

Still very much a depressed economy ...

Series Id: LNS12300060
Seasonally Adjusted
Series title: (Seas) Employment-Population Ratio - 25-54 yrs.
Labor force status: Employment-population ratio
Type of data: Percent or rate
Age: 25 to 54 years

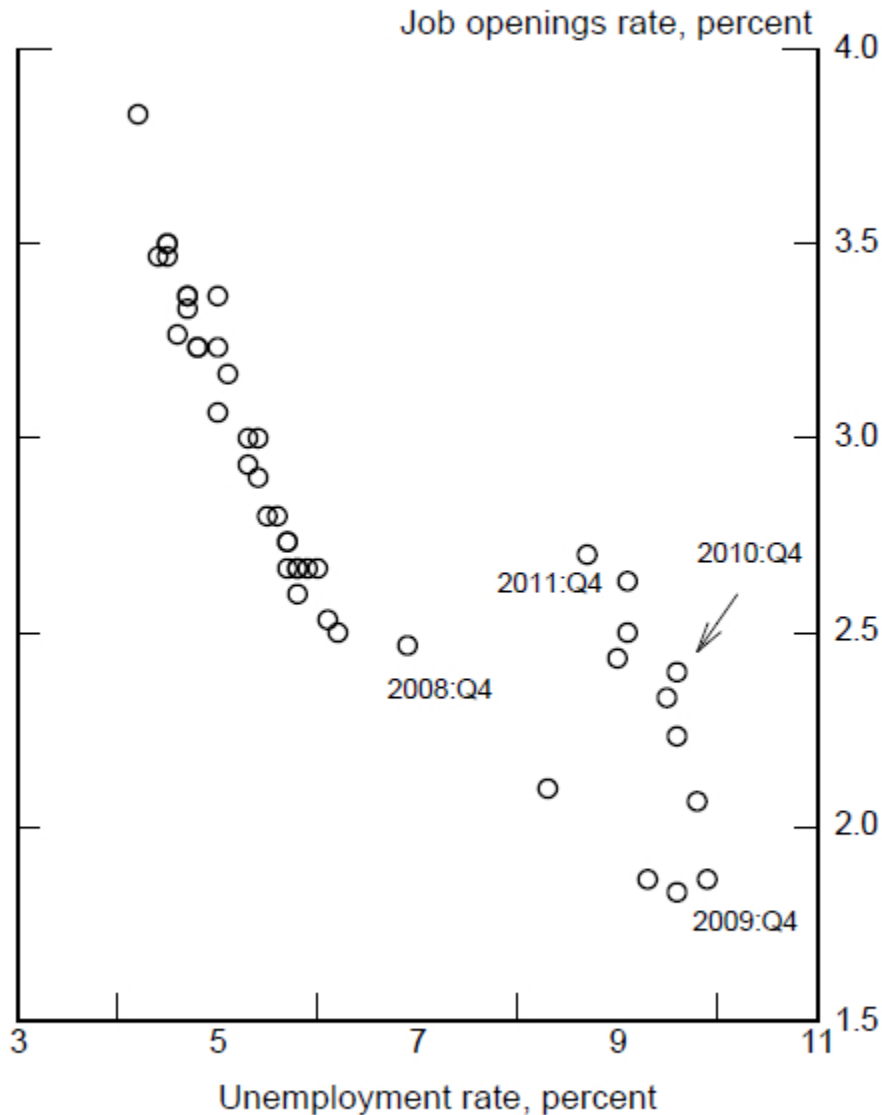


It's not about structural adjustment



Source: Economic Policy Institute analysis of Bureau of Labor Statistics Current Population Survey data.

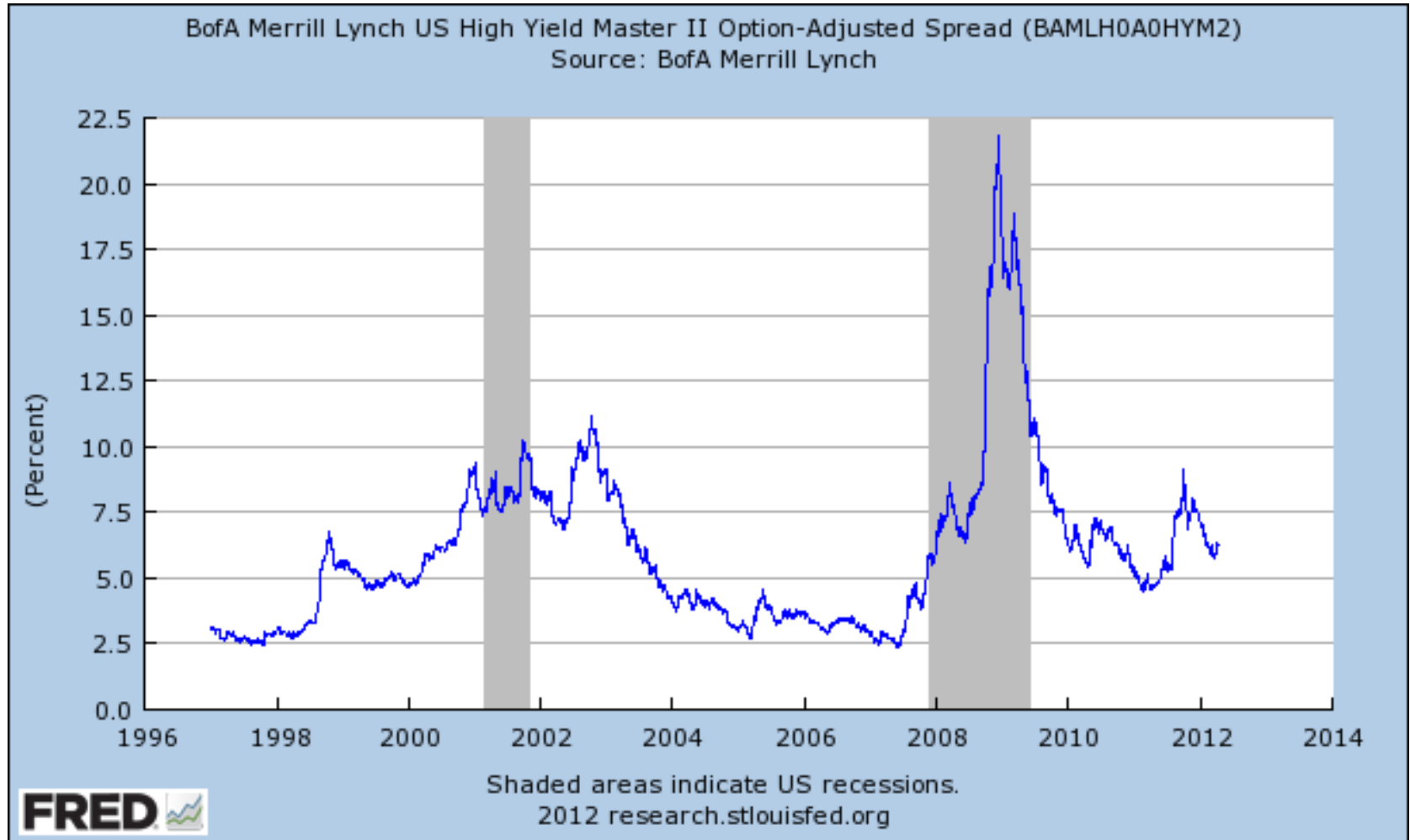
14. Beveridge Curve, 2001--12



Source: U.S. Department of Labor, Bureau of Labor Statistics.

Some hints of a non-binding rise in the NAIRU, but that's probably extended UI, which won't persist if and when we recover

On the AD side: first, Bagehot

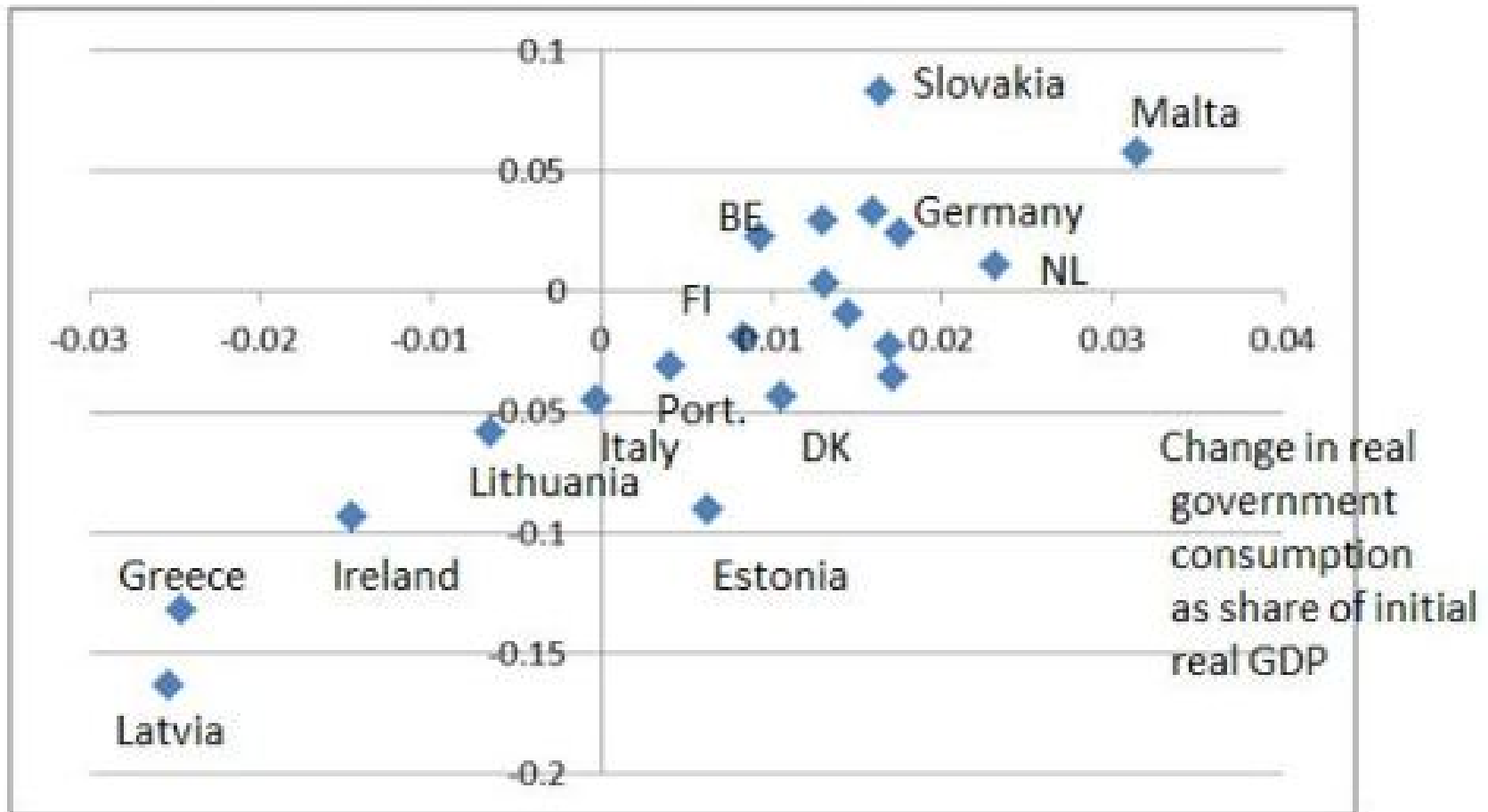


Now, Fisher/Keynes.

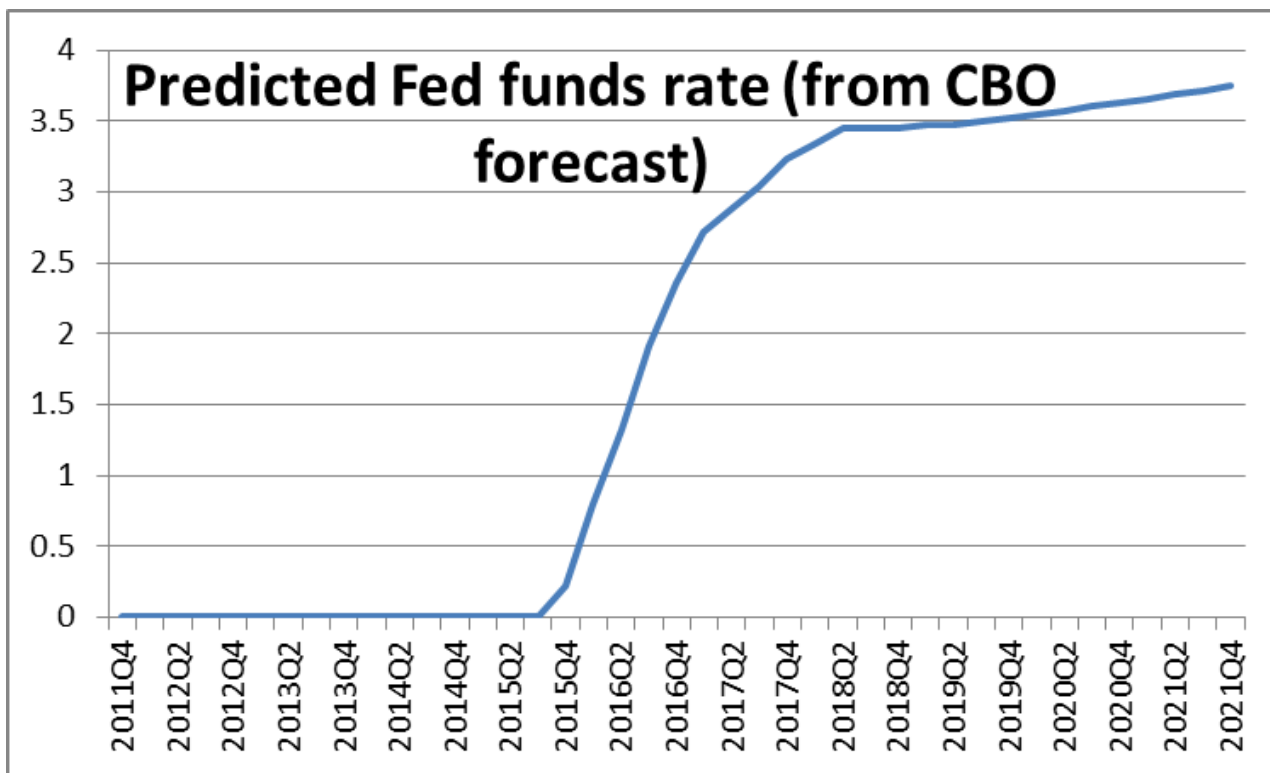
“In particular, it is an outstanding characteristic of the economic system in which we live that, whilst it is subject to severe fluctuations in respect of output and employment, it is not violently unstable. Indeed it seems capable of remaining in a chronic condition of subnormal activity for a considerable period without any marked tendency either towards recovery or towards complete collapse.”

Fiscal policy: finally, a natural experiment that isn't about war -- it's about pestilence instead

Change in real GDP as share of initial real GDP

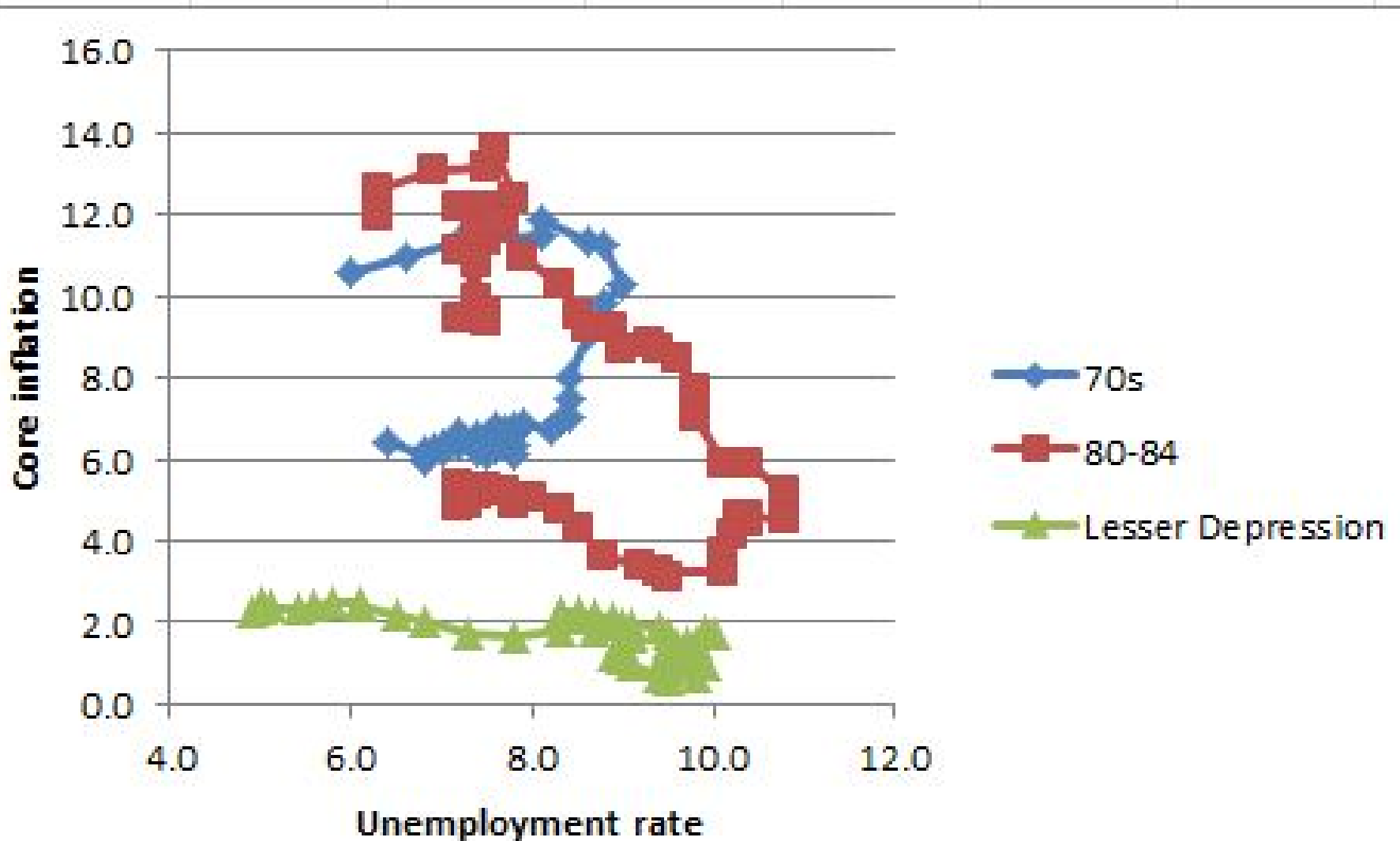


Is there a shortage of safe assets? People who say yes point to very low interest rates on LT government debt. But:

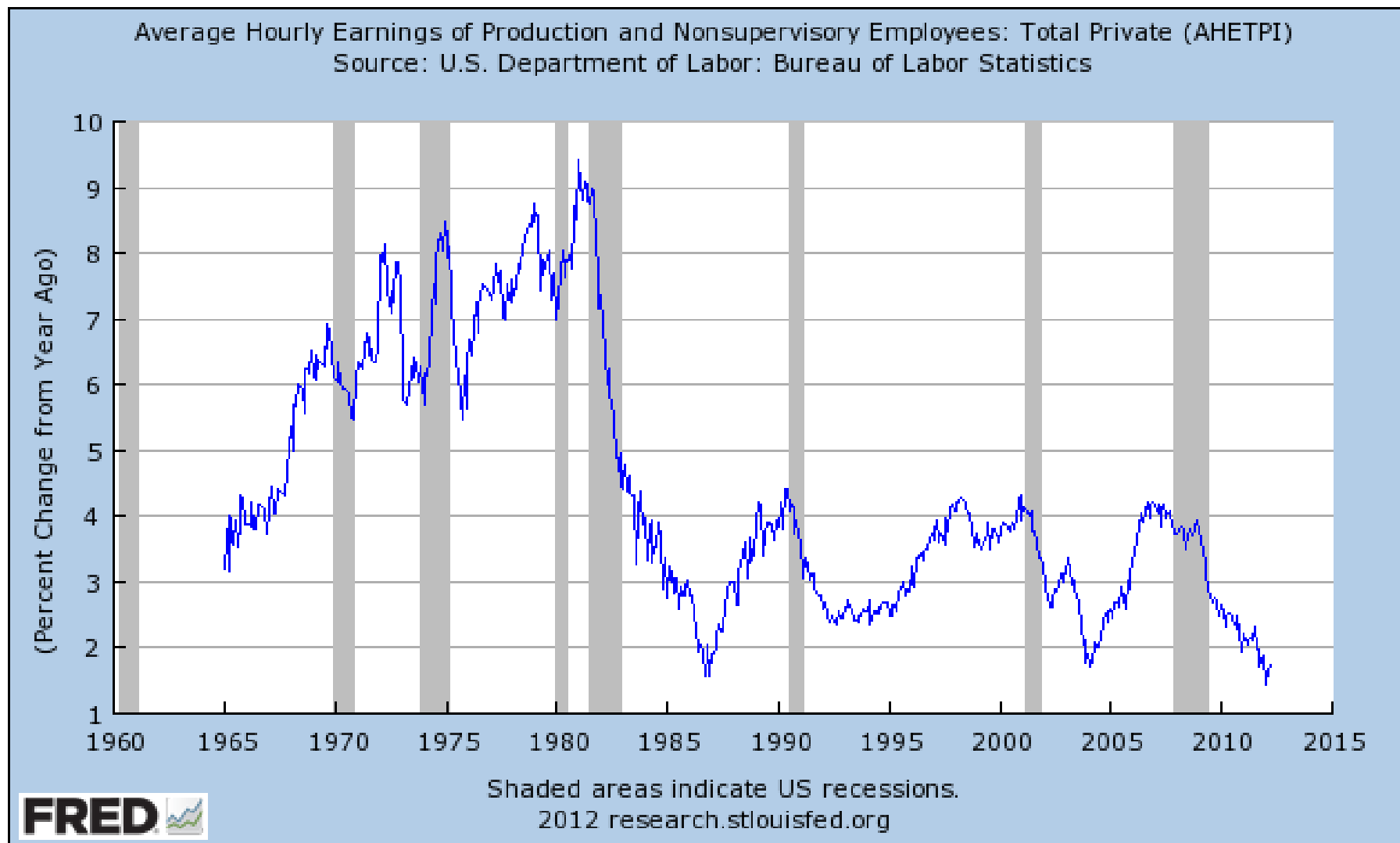


Implied expectational 10-year rate = 1.79%!

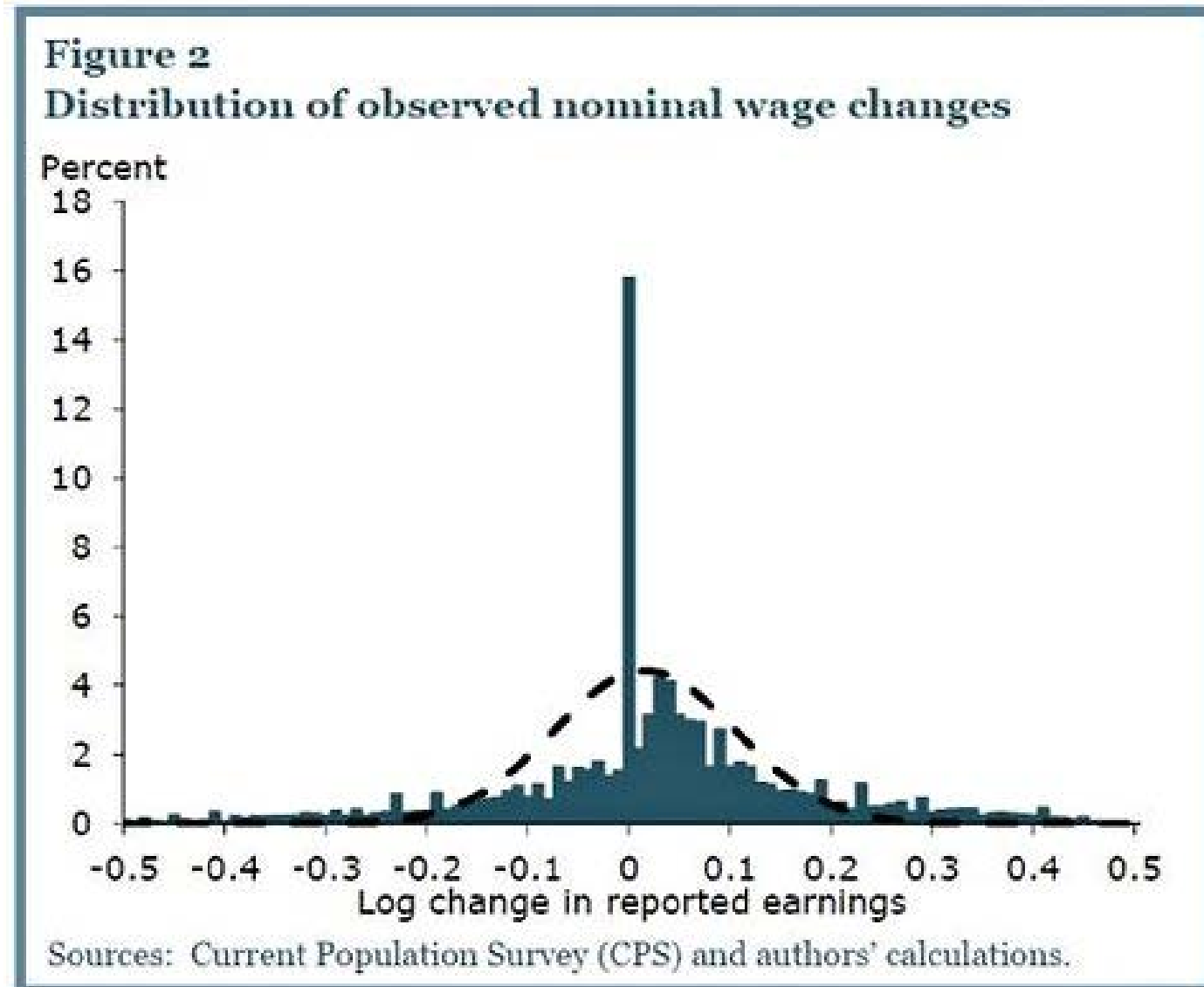
Now, AS: where's the deflation?



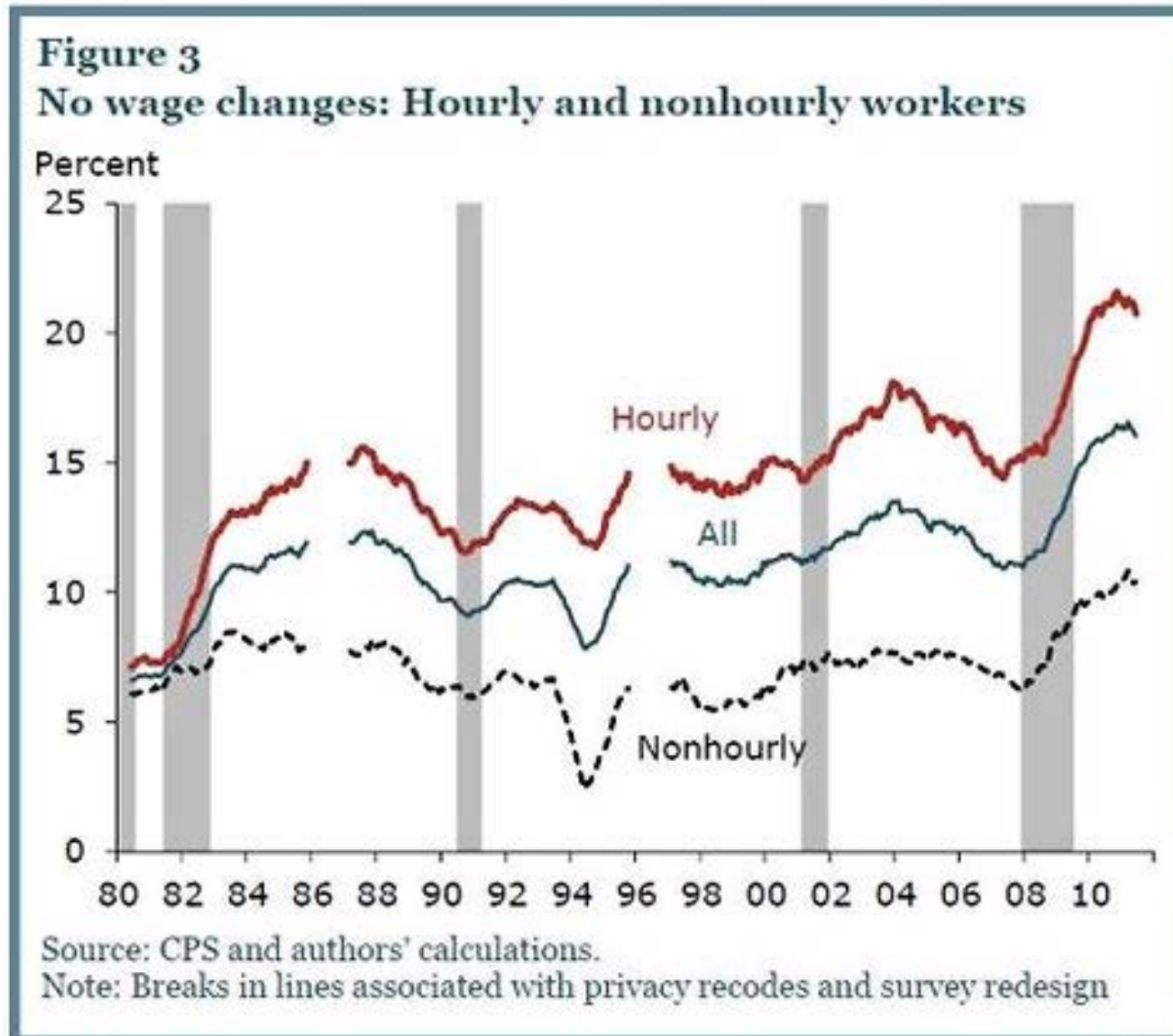
Wages have slowed but not as much as 80-84 would have predicted, and haven't fallen



Strong evidence of downward nominal wage rigidity

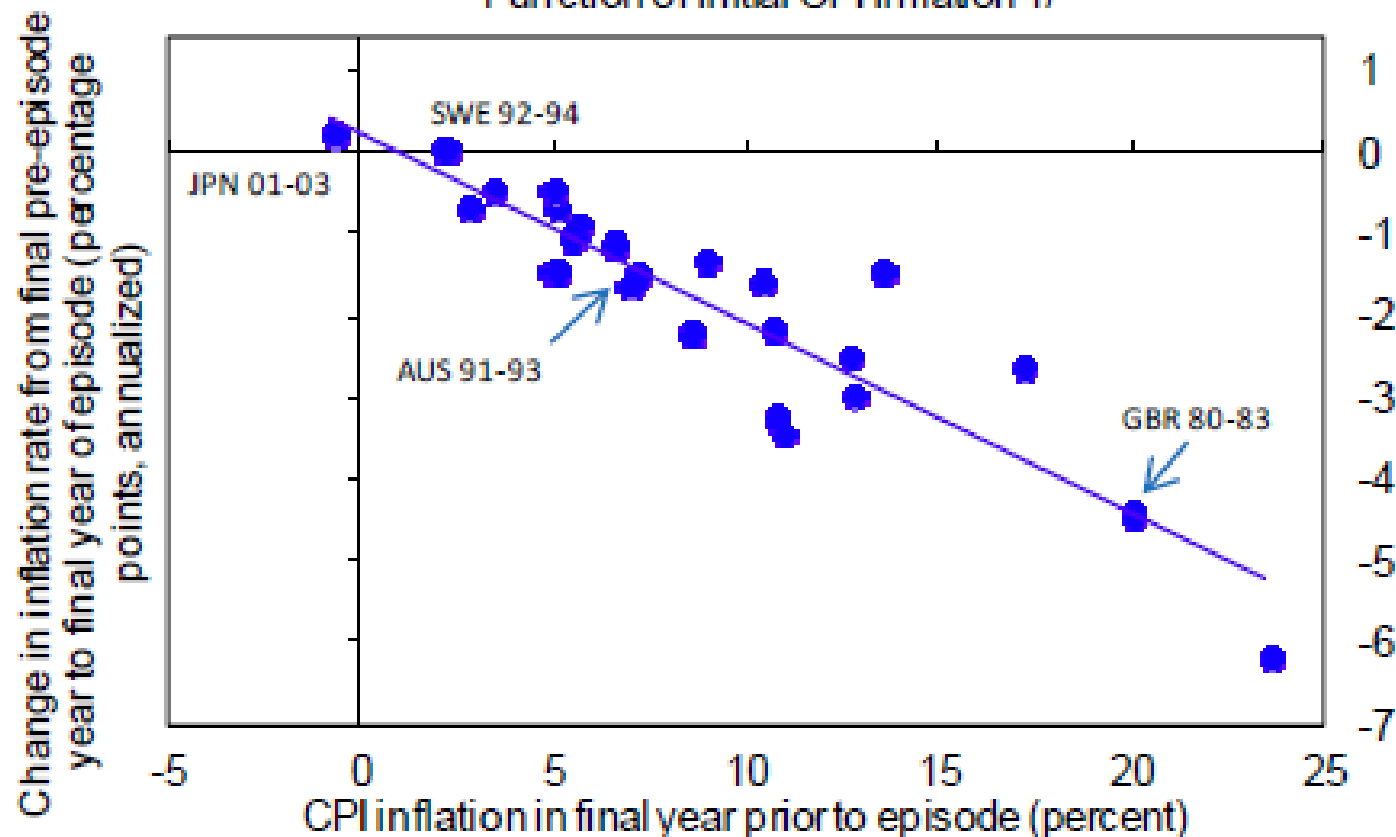


And zero is much more binding than it was a few years ago



So Japanese-style deflation probably not in the cards – but lack of deflation does not indicate all OK

Figure 6. Extent of Disinflation during PLOG Episodes as a Function of Initial CPI Inflation 1/



Source: See Table 1.

1/ Episodes of persistent large output gaps as listed in Table 2.

So what have we learned?

1. Financial crises: this time is not different
2. After the financial crisis, IS-LM-liquidity trap fits the facts
3. Fiscal policy “works”
4. Expectations-augmented Phillips curve breaks down at low infl.

Strong case for reflationary policies; price stability *not* an adequate criterion