Discussion of "Stagnation Traps" by Gianluca Benigno and Luca Fornaro

Robert E. Hall
Hoover Institution and Department of Economics
Stanford University

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The paper

Contributes to two closely related recent literatures: the zero lower bound and secular stagnation

THE PAPER

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Impossible to do the paper justice in 15 minutes, so I'll try to strip it down

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A simple model to capture some basics

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$$c = A$$

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Production of ideas depends negatively on the real rate:

$$\dot{A} = \alpha(r)$$

.

Consumption follows an Euler equation:

$$\dot{c} = \frac{1}{\sigma}(r - \rho)$$

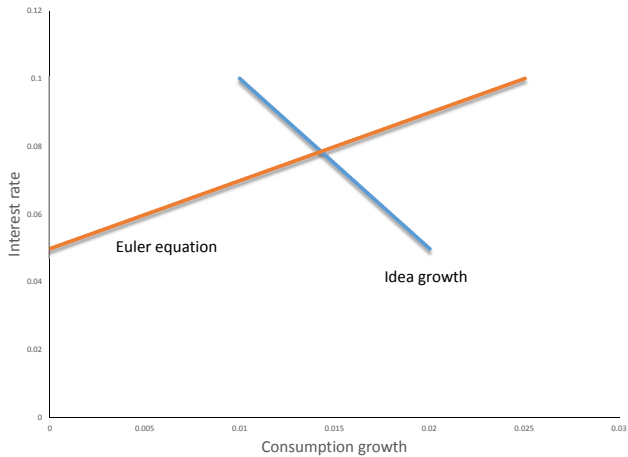## Simple model, continued

Consumption follows an Euler equation:

$$\dot{c} = \frac{1}{\sigma}(r - \rho)$$

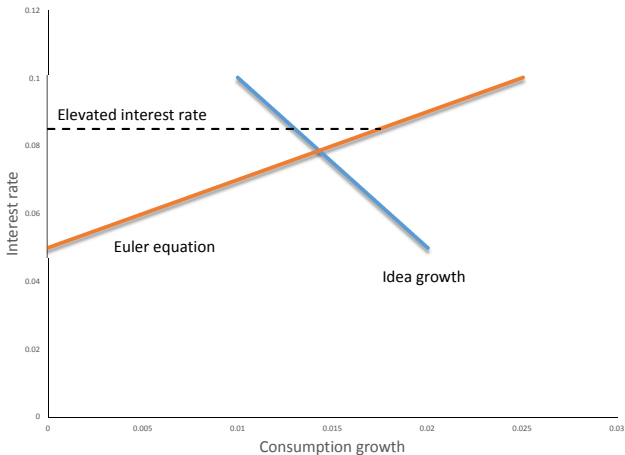Combining yields an equation for r:

$$\alpha(r) = \frac{1}{\sigma}(r - \rho)$$

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EQUILIBRIUM

INTEREST RATE ABOVE EQUILIBRIUM, FROM ZLB OR OTHERWISE

WHAT HAPPENS?

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$$\dot{x} = \dot{c} - \dot{A} = \frac{1}{\sigma}(r_b - \rho) - \alpha(r_b) = \gamma > 0$$
.

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$$u(0) = 1 - e^{-\gamma T} > 0$$

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Conclusions

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The unemployment effect is greater if σ is greater and if the negative sensitivity of $\alpha(r)$ is greater

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Conclusions, continued

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No path of this type holds as a steady state

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LIMITATION OF THE KRUGMAN-STYLE MODEL

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No convincing progress has been made to date to solve this problem

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Real v. nominal interest

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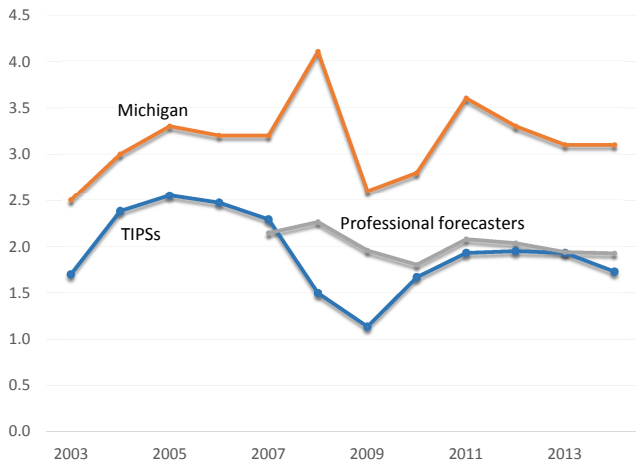
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The ZLB is not an issue in an economy with flexible expected inflation, provided the expected rate rises enough to achieve the equilibrium real rate

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INFLATION EXPECTATIONS

Expected inflation

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With strictly anchored inflation expectations, the analysis based on the real rate is right on point

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Relevance to monetary policy

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above one) implies movements in the real rate

Thus the analysis in the paper in the the ZLB literature applies
at all times—it is the right way to think about the channels of
monetary policy

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