Discussion of “Stagnation Traps” by Gianluca Benigno and Luca Fornaro

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The paper

Contributes to two closely related recent literatures: the zero lower bound and secular stagnation
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Impossible to do the paper justice in 15 minutes, so I’ll try to strip it down
Ideas, $A$, produce consumption, $c$:

$$c = A$$
A simple model to capture some basics

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Production of ideas depends negatively on the real rate:

$$\dot{A} = \alpha(r)$$
Simple model, continued

Consumption follows an Euler equation:

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Simple model, continued

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Combining yields an equation for \( r \):

\[ \alpha(r) = \frac{1}{\sigma}(r - \rho) \]
Equilibrium

![Graph showing the relationship between interest rate and consumption growth. The graph includes a line labeled "Euler equation" and a line labeled "Idea growth." The x-axis represents consumption growth ranging from 0 to 0.03, and the y-axis represents interest rate ranging from 0 to 0.12.](image-url)
INTEREST RATE ABOVE EQUILIBRIUM, FROM ZLB OR OTHERWISE
What happens?

Following Krugman (1998), consider unemployment, in the sense of output not consumed:

\[ c = xA \text{ with } x = 1 - u \]
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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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Paths

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\[ x(t) = e^{\gamma(t-T)} \]

\[ u(0) = 1 - e^{-\gamma T} > 0 \]
The moment the real interest rate is held above its equilibrium, unemployment jumps up, by an amount controlled by the interest-rate gap.
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The unemployment effect is greater if $\sigma$ is greater and if the negative sensitivity of $\alpha(r)$ is greater.
Conclusions, continued

The paper describes an economy with more sensitivity than Krugman considered, as he had $\alpha(r) = 0$. 
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No path of this type holds as a steady state.
Limitation of the Krugman-style model

The model does not describe an equilibrium in the usual sense: Unused output (or unemployed workers) exists when the marginal utility of consumption is positive, a disequilibrium gap.
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No convincing progress has been made to date to solve this problem.
Real v. nominal interest

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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.
Inflation Expectations

[Graph showing inflation expectations from 2003 to 2013 for Michigan, TIPSs, and Professional forecasters.]
EXPECTED INFLATION

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With strictly anchored inflation expectations, the analysis based on the real rate is right on point
Relevance to monetary policy

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