Lessons from the 1970s: The “Great Inflation”

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Hello everyone, I’m **Susanna Grigoryan** from the Monetary Policy Department at the Central Bank of Armenia. Welcome to this episode of the CBA Academy series.

Today, we’ll look back at one of the most important chapters in modern monetary history — the Great Inflation of the 1970s. It’s a story about how economic thinking evolved, how mistakes were made, and how central banks learned to rebuild credibility. These lessons continue to shape our policies and our understanding of how to manage uncertainty even today.

In the 1960s, many economists believed there was a stable trade-off between inflation and unemployment, an idea captured by the Phillips Curve. Policymakers thought they could keep unemployment permanently lower by tolerating a bit more inflation. But this belief turned out to be dangerously misleading.

Economists like Milton Friedman and Edmund Phelps challenged that thinking. They introduced what became known as the natural rate hypothesis — the idea that trying to keep unemployment below its natural level would only cause inflation to accelerate. By the early 1970s, this became painfully clear. Governments and central banks continued to stimulate demand even as inflation expectations rose. Then came the oil price shocks, which pushed inflation even higher and exposed the limits of trying to fine-tune the economy.

The result was the Great Inflation — a period of rising prices, falling real incomes, and growing doubts about the effectiveness of macroeconomic policy. It took decisive action to restore stability, most famously under Paul Volcker at the U.S. Federal Reserve. His approach was painful, involving deep recessions and difficult policy choices, but it succeeded in bringing inflation down and restoring credibility to monetary policy.

The lessons from that period remain at the heart of modern central banking. First, there is no long-run trade-off between inflation and unemployment. Once people and firms adjust their expectations, higher inflation brings no lasting benefit — only higher inflation. Second, credibility matters. Central banks must earn and maintain public trust through consistent and transparent actions. And third, humility is essential. The economy is complex and uncertain, and the 1970s taught policymakers to respect that uncertainty, to understand policy lags, and to avoid excessive confidence in any single model or forecast.

These lessons continue to guide the way we design and implement monetary policy frameworks today — including the Central Bank of Armenia's Prudent Risk Management Approach, or FPAS Mark II. This approach treats policy as a continuous process of learning and decision-making under uncertainty. It recognizes that what matters most is not claiming precision, but managing risks prudently and communicating clearly.

I would like to thank Douglas Laxton from the Better Policy Project, and my colleagues Jared Laxton, Asya Kostanyan, and Sopio Mkervalidze from the Global Forecasting School for their guidance and feedback in preparing this episode.

The 1970s taught central banks around the world a simple but powerful lesson: credibility is earned through consistent and transparent action. Thank you for joining me, and I look forward to continuing this learning journey with you in future episodes of the CBA Academy.

See you there.

Literature & Further Reading

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