

Phillips curve

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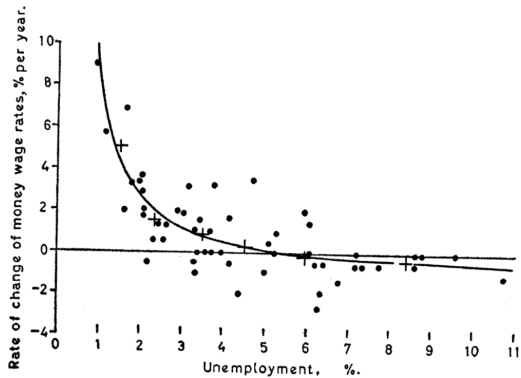


Fig.1.1861 - 1913

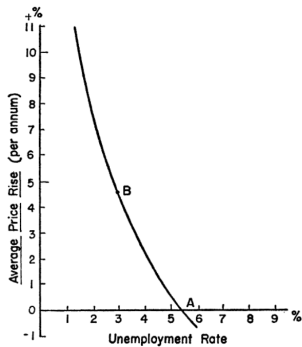
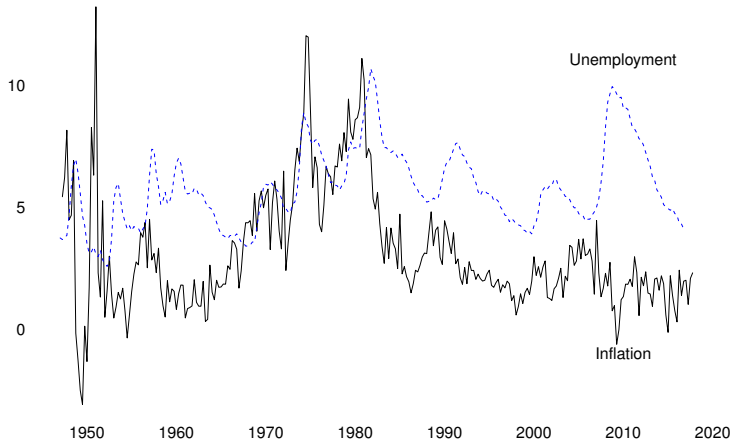
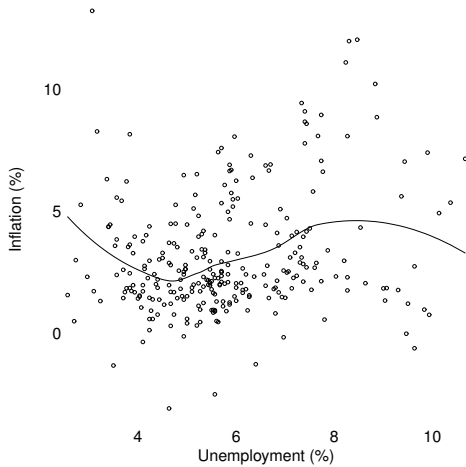


FIGURE 2

MODIFIED PHILLIPS CURVE FOR U.S.

This shows the menu of choice between different degrees of unemployment and price stability, as roughly estimated from last twenty-five years of American data.





Peterson Institute conference

- ▶ Blanchard: still exists, hard to pin down
- ▶ Summers: agnostic
- ▶ Draghi: ...

Friedman:

$$\pi_t = \mathbb{E}\pi_t - \gamma(U_t - U^*) \quad (1)$$

In long run

$$\mathbb{E}\pi_t \approx \pi_t \quad (2)$$

i.e. $U_t \approx U^*$

Accelerationist Phillips curve

$$\mathbb{E}\pi_t = \pi_{t-1} \quad (3)$$

$$\pi_t = \pi_{t-1} - \gamma(U_t - U^*) \quad (4)$$

1. $U_t < U^*$: increase in π
2. $U_t > U^*$: decrease in π

Non-accelerating Inflation Rate of Unemployment (NAIRU)

$$\pi_t = \sum_{i=1}^N \beta_i \pi_{t-i} - \gamma(U_t - U^*) \quad (5)$$

U^* is unknown but can be estimated

$$\pi_t = \alpha - \gamma U_t + \sum_{i=1}^N \beta_i \pi_{t-i} \quad (6)$$

$$\alpha - \gamma U^* = 0 \Rightarrow U^* = \frac{\alpha}{\gamma} \quad (7)$$

Implications for policy analysis

1. Inflation: highly inertial; shock t takes long time to disappear
- 2.

$$\mathbb{E}\pi_t = \pi_{t-1} \quad (8)$$

Backward-looking: hard to decrease π without increase U

Best course of action: let monetary policy reduce π gradually over time

Critique of Keynesianism

$$\pi_t = \mathbb{E}\pi_t - \gamma(U_t - U^*) \quad (9)$$

Can have $U_t \neq U^*$ only when there is unexpected inflation

- ▶ $\pi_t \neq E\pi_t$

IF expectations are rational, then

- ▶ Unexpected inflation is random and unpredictable
- ▶ No room for systematic predictable stabilisation
 - ▶ No PC; little central bank can do

RE advocates believed that monetary policy had little to do with business cycles

Blanchard et al. (2015)

$$\pi_t = \theta_t(u_t - u_t^*) + \lambda_t \pi_t^e + (1 - \lambda_t) \pi_{t-1}^* + \mu_t \pi_{mt} + \epsilon_t \quad (10)$$

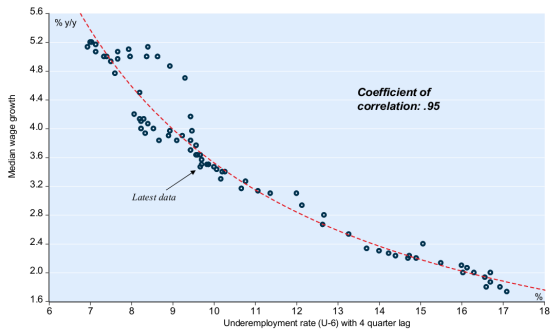
$$\pi_t^e = a_t + \beta_t \pi_{t-1}^* + \eta_t \quad (11)$$

Inflation determined by unemployment, but also by

1. Inflation expectations
2. Inflation history
3. Import prices
4. Random shock

U.S.: With the right variables, the Philips curve works

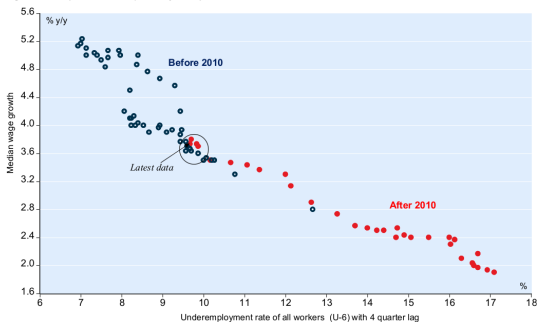
Phillips curve defined as relationship between underemployment rate and median wage growth (1998-2017, quarterly data)



NBF Economics and Strategy (data via BLS and Atlanta Fed)

U.S.: Prime-age workers are doing just fine

Phillips curve defined as relationship between underemployment rate and median wage growth of workers aged 25-54 (1998-2017, quarterly data)



NBF Economics and Strategy (data via BLS and Atlanta Fed)