Secular Stagnation?

Prof. Lutz Hendricks

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Outline

The idea: even 8 years after the onset of the financial crisis, the economy has not fully recovered

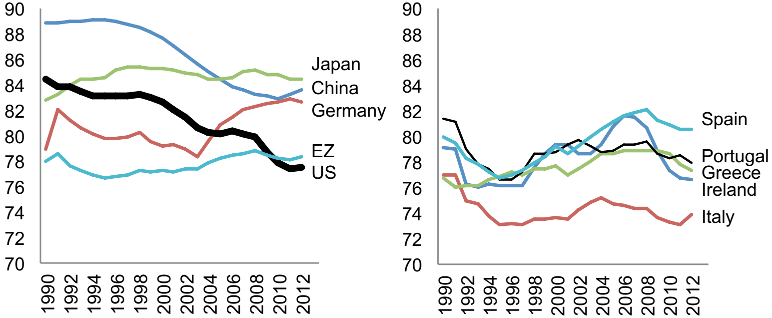
- employment is still low
- interest rates are near zero
- output growth in the recovery has been slow

Questions:

1. Does this represent a permanent reduction in growth?
2. Are zero interest rates no longer enough to maintain full employment?

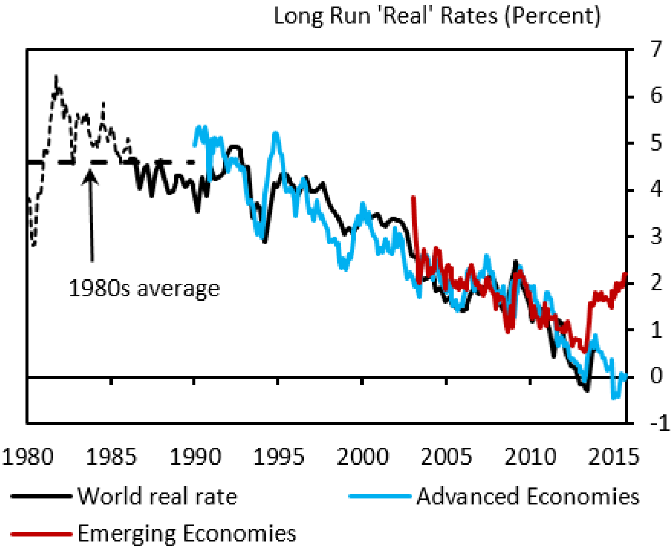
Fewer Prime-age Males Work

Figure 2 Labour force participation rate of men aged 15-64, 1990 – 2012.



Source: Teulings and Baldwin (2014)

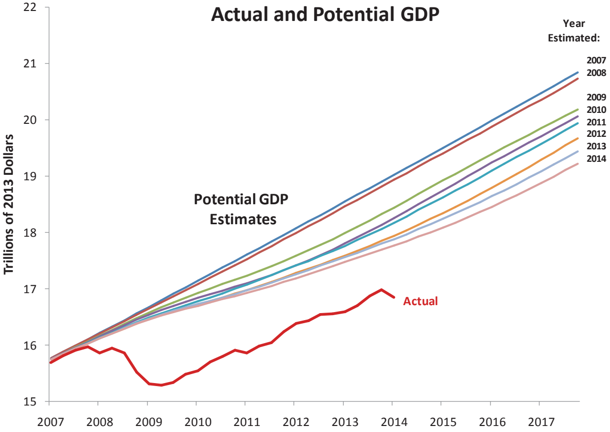
Falling Real Interest Rates



Source: Rachel and Smith (2016)

Slow Output Growth

Figure 1a Actual and potential GDP in the US

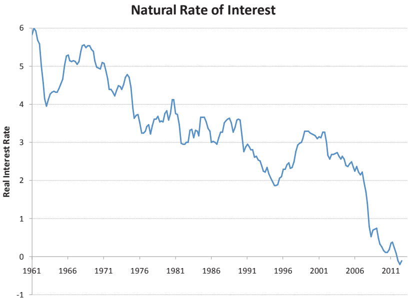


Source: Summers (2014)

Policy Implications

One interpretation: the natural rate has been falling for a long time

Figure 4 US natural rate of interest

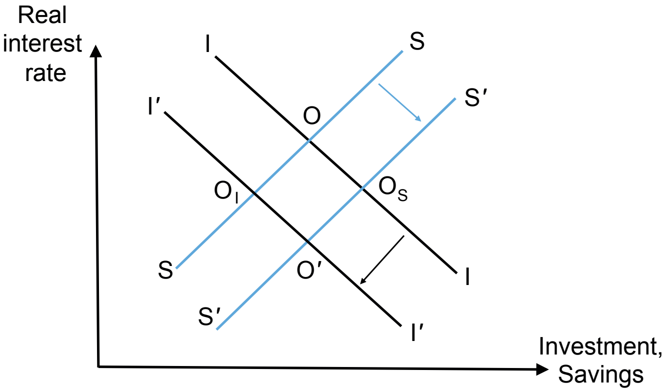


Source: Summers (2014)

Standard monetary policy no longer works (zero lower bound)

Why Did Interest Rates Fall?

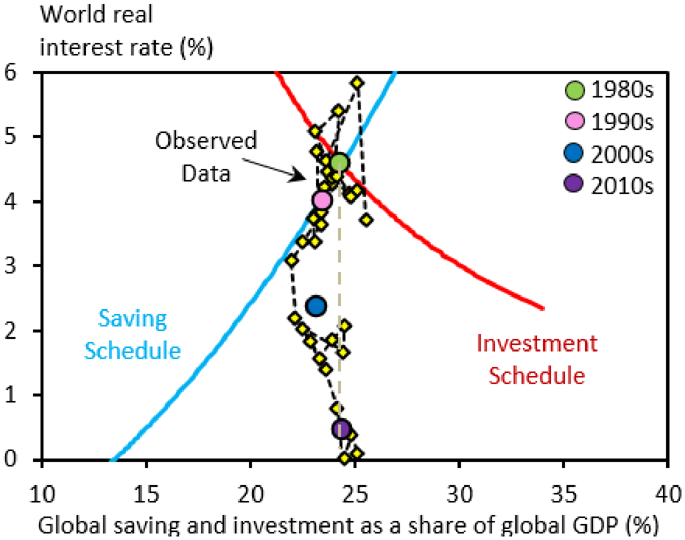
Conceptual framework: market for loanable funds



Global saving / investment rates have been roughly constant over time

Suggests a decline in SS and II schedules

Saving and Interest Rates



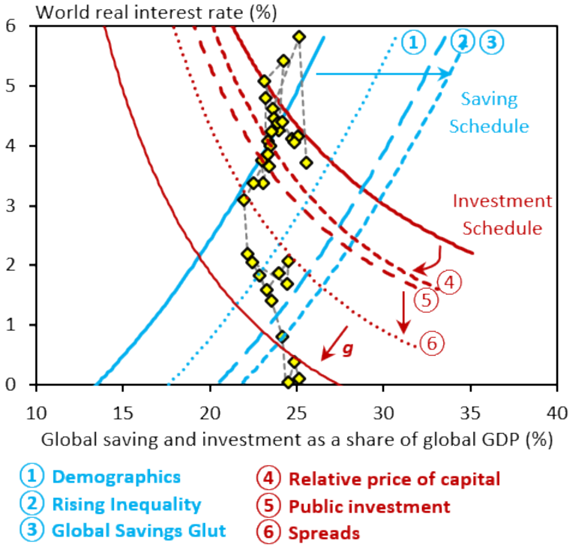
Source: Rachel and Smith (2016)

Suggests that saving and investment schedules have shifted down

Possible Causes

- demographics:
  - fraction of older people has increased
- global savings glut
  - China's integration into world markets
- innovations require little capital (WhatsApp)
- increased demand for safe assets

Possible Causes



Source: Rachel and Smith (2016)

Policy Implications

Zero lower bound:

- in downturns, interest rates required for full employment may hit ZLB (Japan)
- conventional monetary policy becomes ineffective

Forward Guidance

Raise expected inflation by promising loose monetary policy past the end of the current downturn.

Inflation expectations rise $\Longrightarrow$ real interest rates falls.

Problems:

- not time consistent
- not helping if the private sector views the crisis as long lived

Quantitative Easing

Central bank buys assets (typically government bonds), sells reserves.

Effects:

1. bank liquidity channel
   banks have more liquidity; **may** extend more credit (or not)
2. portfolio rebalancing channel
   private sector buys other assets (bonds)
   yields decline
3. signalling channel

Higher Inflation Target

The idea: keep inflation expectations high $\Longrightarrow$ real interest rates are lower

Is it credible in a crisis when inflation is far below target?

Reading

A detailed and readable survey is Bean and Broda (2015)

References I

Bean, C. and C. Broda (2015): *Low for Long? Causes and Consequences of Persistently Low Interest Rates*, CEPR Press.

Rachel, L. and T. Smith (2016): "Towards a global narrative on long-term real interest rates," .

Summers, L. H. (2014): "Reflections on the 'New Secular Stagnation Hypothesis'," in *Secular Stagnation: Facts, Causes, and Cures*, ed. by C. Teulings and R. Baldwin, CEPR Press.

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