Explaining deviations from Okun’s law

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Date:2022-08-05

Keyword:NA

Url:[click here](https://www.ecb.europa.eu/pub/research/working-papers/html/papers-2022.include.en.html)

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AbstractDespite its stability over time, as for any statistical relationship, Okun’s law is subject to deviations that can be large at times. In this paper, we provide a mapping between residuals in Okun’s regressions and structural shocks identified with a SVAR model by inspecting how unemployment responds to the state of the economy. We show that deviations from Okun’s law are a natural and expected outcome once one takes a multi-shock perspective, as long as shocks to automation, labour supply and structural factors in the labour market are taken into account. Our simple recipe for policy makers is that, if a positive deviation from Okun’s law arises, it is likely to be generated by either positive labour supply or automation shocks or by negative structural factors shocks.JEL CodeE24 : Macroeconomics and Monetary Economics→Consumption, Saving, Production, Investment, Labor Markets, and Informal Economy→Employment, Unemployment, Wages, Intergenerational Income Distribution, Aggregate Human CapitalE32 : Macroeconomics and Monetary Economics→Prices, Business Fluctuations, and Cycles→Business Fluctuations, CyclesC32 : Mathematical and Quantitative Methods→Multiple or Simultaneous Equation Models, Multiple Variables→Time-Series Models, Dynamic Quantile Regressions, Dynamic Treatment Effect Models, Diffusion Processes