Lower for longer under endogenous technology growth

Author:Michaela Elfsbacka SchmöllerMartin Spitzer

Date:2022-08-18

Keyword:NA

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

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From:ECB-working\_paper

AbstractThis paper studies monetary policy strategies under endogenous technology dynamics and low r\*. Endogenous growth strengthens the gains from make-up strategies relative to inflation targeting, especially if policy space is reduced. This result is due to the long-run non-neutrality of money and the hysteresis effects in TFP through which ELB episodes generate permanent scars on long-run aggregate supply. Make-up strategies not only foster the alignment of inflation with target but also support productivity-improving investment in R&D and technology adoption and hence the long-run trend path, provided that the inherent make-up element is sufficiently pronounced. Inflation is less responsive to monetary policy due to the interaction with productivity dynamics. As a result, additional stimulus is required at the ELB and the degree of subsequent overshooting is alleviated. Endogenous growth also generates novel monetary policy trade-offs, most notably credibility challenges, which can be mitigated by confining make-up elements to ELB episodes.JEL CodeE24 : Macroeconomics and Monetary Economics→Consumption, Saving, Production, Investment, Labor Markets, and Informal Economy→Employment, Unemployment, Wages, Intergenerational Income Distribution, Aggregate Human CapitalE31 : Macroeconomics and Monetary Economics→Prices, Business Fluctuations, and Cycles→Price Level, Inflation, DeflationE32 : Macroeconomics and Monetary Economics→Prices, Business Fluctuations, and Cycles→Business Fluctuations, CyclesE52 : Macroeconomics and Monetary Economics→Monetary Policy, Central Banking, and the Supply of Money and Credit→Monetary PolicyO30 : Economic Development, Technological Change, and Growth→Technological Change, Research and Development, Intellectual Property Rights→General