The Macroeconomic Consequences of Natural Rate Shocks An Empirical Investigation

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Much of the empirical literature on the natural rate of interest has focused on estimating its path. This paper addresses the question of how exogenous movements in the natural rate of interest affect aggregate activity and inflation in the short and long runs. To this end it proposes a semi-structural model of output, inflation, and the policy interest rate inspired by the DSGE literature but with fewer identification and cross-equation restrictions. It then estimates it on U.S. data over the period 1900 to 2021. We find that a permanent decline in the natural rate of interest has a large negative effect on the trend of output and is contractionary and deflationary in the short run. When the economy is constrained by the zero lower bound (ZLB), these results are consistent with the secular stagnation hypothesis. However, we find that negative natural rate shocks depress the trend of output even when the economy is away from the ZLB. Thus, the results of this paper call for a more general theory of the trend effects of natural rate shocks.