Policy Analysis in the Post Great Recession Era

Peter Rupert
Department of Economics, UCSB
Associate Director, LAEF

Istanbul
October 17, 2014
Issues Facing Various Policy Makers

- US economy and the Fed
  - slow growth
  - labor market weak
  - inflation low
  - households deleveraging
  - cash holdings are high
- Europe economies also very weak
GDP Growth During an Expansion
Average, annualized rate of change
Transition Rate from Part–time for Economic Reasons to Full–time
Probability of getting a full time job during the year, Seasonally Adjusted

Source: U.S. Department of Labor
Personal Consumption Expenditures, Chain-type Price Index

Percent change from last year
Average Hourly Earnings, Production and Salary Workers, Total Private
Percent change from a year ago

Economic Forecast Project
Source: BLS
Household Net Worth (Assets–Liabilities)

Ratio to GDP

Economic Forecast Project
Source: Flow of Funds, Federal Reserve
Real Personal Consumption Expenditures
Annualized percent change from last quarter
So?

- what problems are we facing?
- are we stuck somehow?
- Benhabib, Schmitt-Grohe, Uribe (2001)
Figure 1
Interest Rates and Inflation in Japan and the U.S.

NOTE: Short-term nominal interest rates and core inflation rates in Japan and the United States, 2002-10.
SOURCE: Data from the Organisation for Economic Co-operation and Development.
Long-Term Government Bond Yields: 10-year: Main (Including Benchmark) for Japan

Source: Organisation for Economic Co-operation and Development
2014 research.stlouisfed.org
Waiting for a Rate Change?

- don’t hold your breath

- given substantial weakness in the labor market

- and no evidence of inflation in sight
What Next?

- increase nominal rates?

- ECB presumably wants to increase inflation...how?
What Next?

- QE?
  - Draghi: “So QE is an outright purchase of assets. To give an example: rather than accepting these assets as collateral for lending, the ECB would outright purchase these assets. That’s QE. It would inject money into the system.”

- why should that matter?
- TLTRO: subsidized lending...how does expansion of credit or reallocation lead to inflation?
- reducing refinancing rate (0.05%) and interest on reserves (-0.20%)...here think about the Bullard picture above
- “policy” trap
What Next?

- forward guidance?
Appropriate pace of policy firming: Midpoint of target range or target level for the federal funds rate
What Next?

- but lots of uncertainty remains in the US

- too-big-to-fail and bailouts
What Next?

- growth is the way out
- not stimulus
- structural reform is key
  - labor markets, business climate, deficits, etc.
Gross Federal Debt Held by the Public
Percent of GDP

Economic Forecast Project
Source: FRB St. Louis
Thank You