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Teaching Secular Stagnation

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Teaching Secular Stagnation

Sebastien Buttet Udayan Roy

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November 6th, 2015

Outline

1 Background

2 Model

3 Concluding Remarks

Background

- Lots of research and policy debate about Secular stagnation following Summers 2013 IMF speech

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- No consensus about how to define Secular Stagnation (VOX EU collection of papers 2014)
- Summers' definition: drop in the natural interest rate.

Research Question

How can we modify a simple Neo-Keynesian of the business cycles to teach secular stagnation in Intermediate Macroeconomics courses?

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A simple Keynesian Model of the Business Cycle

IS-PC-MR Model

- Aggregate demand: $Y_t = \bar{Y}_t - \alpha(r_t - \rho) + \epsilon_t$

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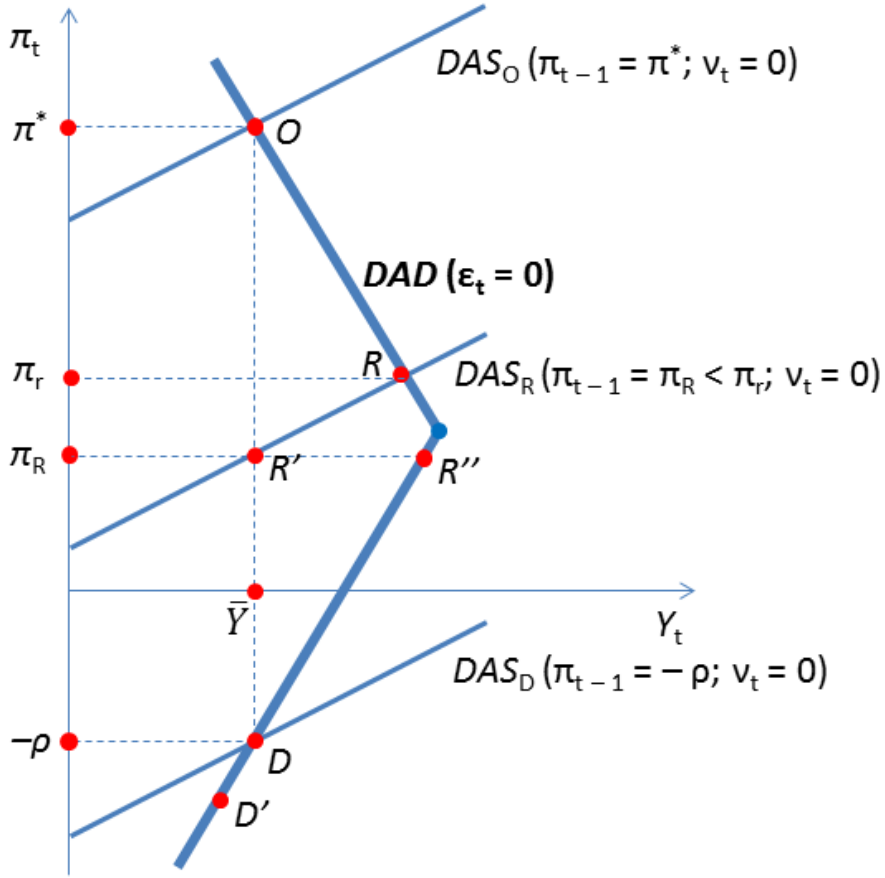
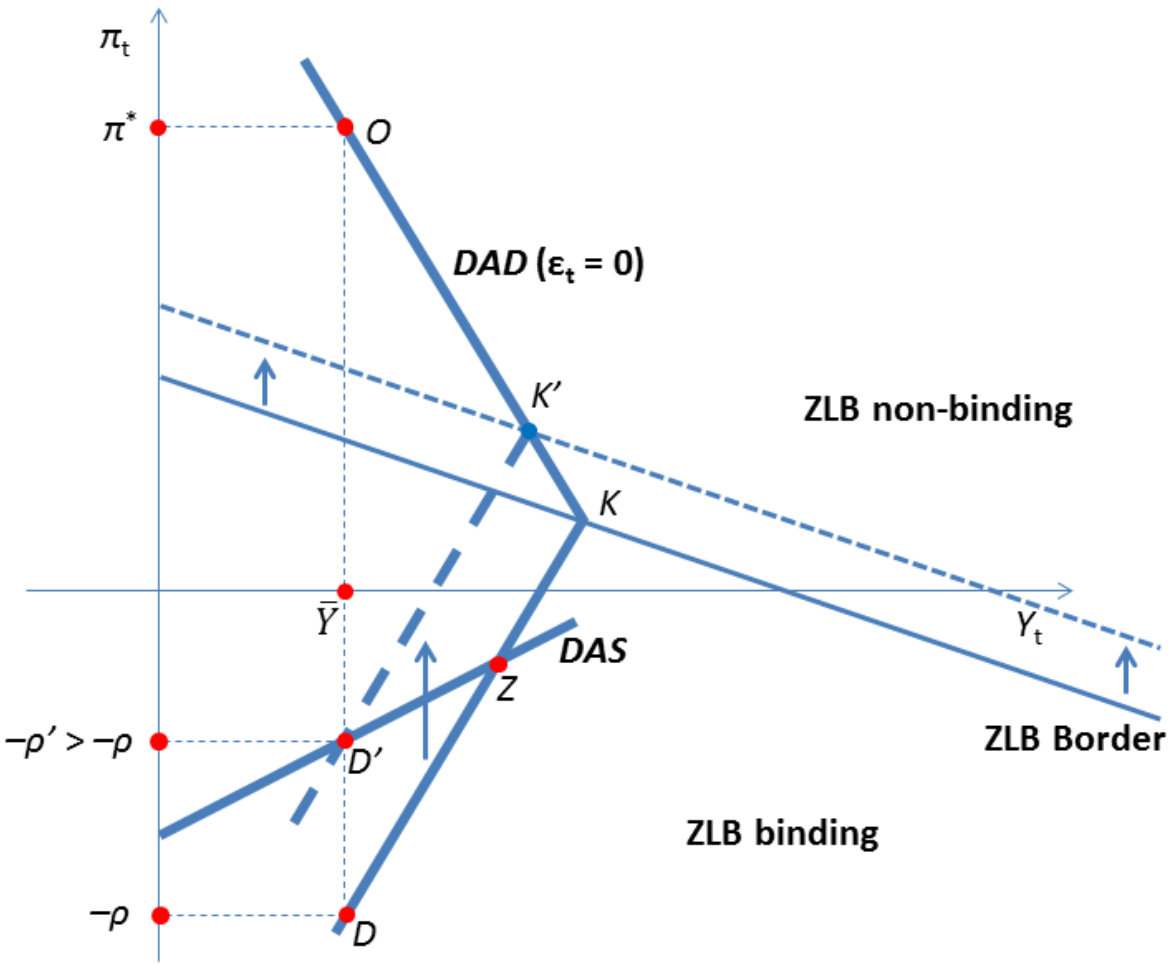
  $i_t = \max\{0, \pi_t + \rho + \theta_{\pi t}(\pi_t - \pi_t^*) + \theta_{Yt}(Y_t - \bar{Y}_t)\}$
- Fisher equation: $r_t = i_t - \pi_t$

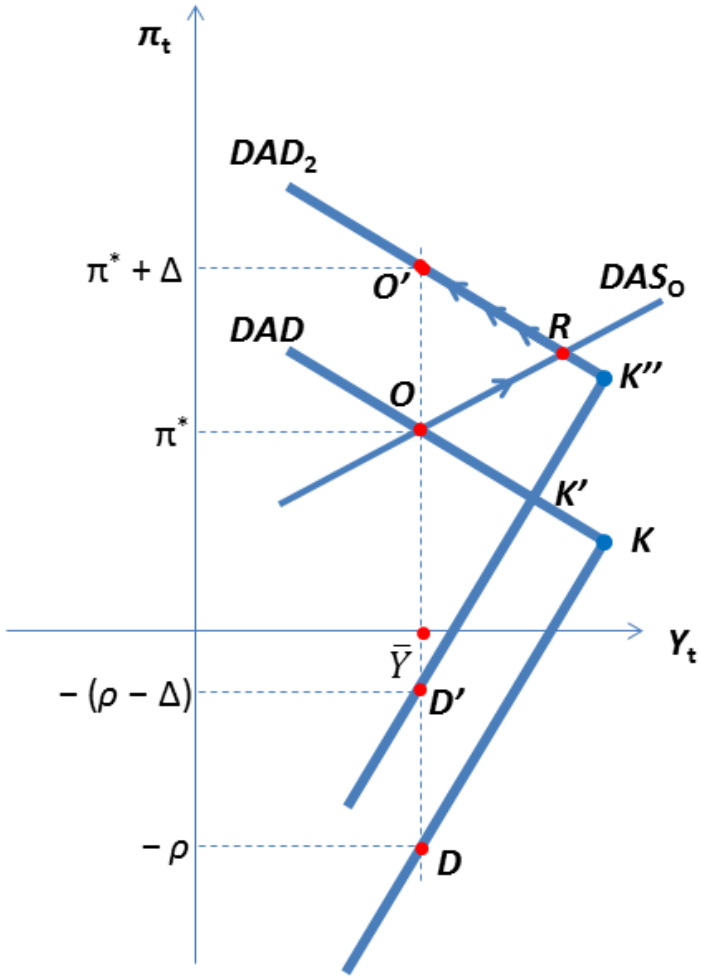
Equilibrium



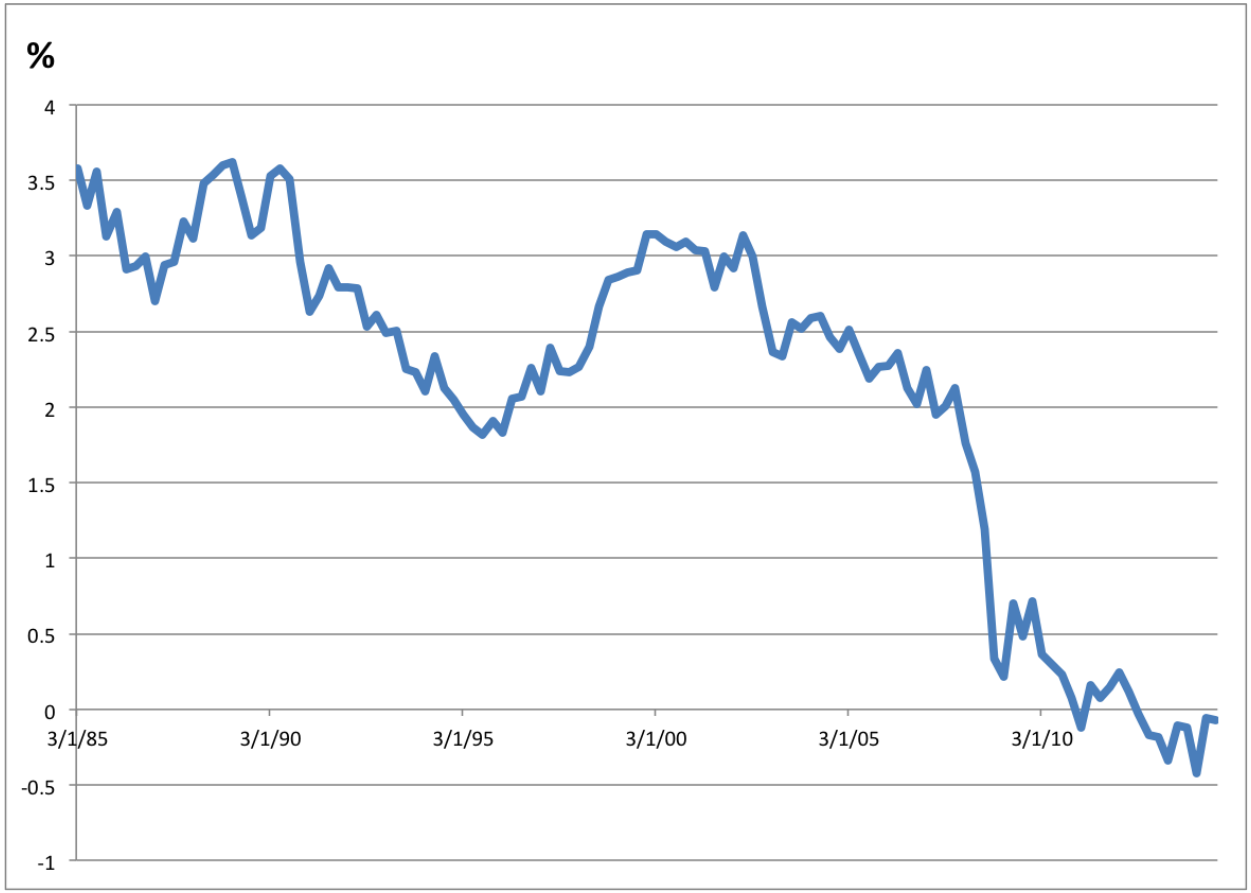
Drop in Natural Interest rate



Raise inflation target



Data



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- Interesting result: Central bank should raise inflation target even when the ZLB is *not* binding to counter deflationary threats