

Heroes of the zeroes

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A great achievement

- Getting inflation under control was a truly great achievement
- In the past few decades most of OECD countries have grown fast and **steadily**. This means that monetary policy was used successfully
- Central bankers can also share in the credit for smoothing the **cycle**
- The worrying thing is that the hard-fought lessons of monetary policy can all too easily be forgotten

Interest rate and inflation

- When FOMC cut rates, it was careful to point out that “some inflation risks remains” and to stress that it “will continue to monitor inflation developments carefully”
- But there are longer-term threats
- Greenspan thinks that globalization **was** a disinflationary force. **But this may not be so in the future.**

Phillips curve

- Britain data from 1860s to 1950s: A trade-off between inflation rate and unemployment
- In the late 1960s, the Phillips curve suffered assaults—first from theory, then from fact

Natural Rate of Unemployment

- Milton Friedman: the “natural rate of unemployment” or NAIRU (non-accelerating inflation rate of unemployment)
- At first unemployment is at u^* , (expected) inflation is p^0
- Loose monetary policy lowers nominal interest rate, stimulates spending, and unemployment goes down to u^1
- Higher demand will push up prices

Natural Rate of Unemployment

- 名目工資率是依據預期物價膨脹率訂定。若物價膨脹率之預期尚未改變, 短期內物價膨脹率上升將使實質工資率下降 (廠商的雇用增加, 失業率下降)
- 但物價上升會改變員工對於物價膨脹率之預期, 要求提高名目工資率, 故實質工資率上升
- 實質工資率上升時, 廠商的勞動需求調整下降

Expectations

- When **inflation expectations** is raised, workers demand wage increases. Firms shed labor, and unemployment rises again, to u^*
- LRPC (Long-run Phillips curve) is vertical
- In the 1970s, Phillips curve seems to be slopping upward

Phillips curve?

- Robert Lucas: If workers and firms could anticipate the effects of changes in policy, their behavior would alter accordingly
- Even in the short run, the curve could be mainly vertical
- In the 1990s, the Phillips curve has been flattening. That is, you can reduce unemployment without raising inflation

Central bank credibility

- Central banks have won credibility, anchoring inflation expectations
- Michael Woodford: “Not only do expectations about policy matter. But, at least under current conditions, very little else matters,”

The danger

- If central banks loosen policy too far and too fast, markets and the public may believe that they care less about inflation.
- Inflation will be high, and unemployment will also be high.