Heroes of the zeroes

The Economist

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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.
• 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，短期内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
• 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.