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Comments of “Aggregate Supply in the United States: Recent Developments and Implications for the Conduct of Monetary Policy”

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Paper presented at the 14th Jacques Polak Annual Research Conference
Hosted by the International Monetary Fund
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Discussion of Reifschneider, Wascher, and Wilcox

Greg Mankiw

November 2013

A minute on Stan Fischer

Photo Credit: Bob Gordon

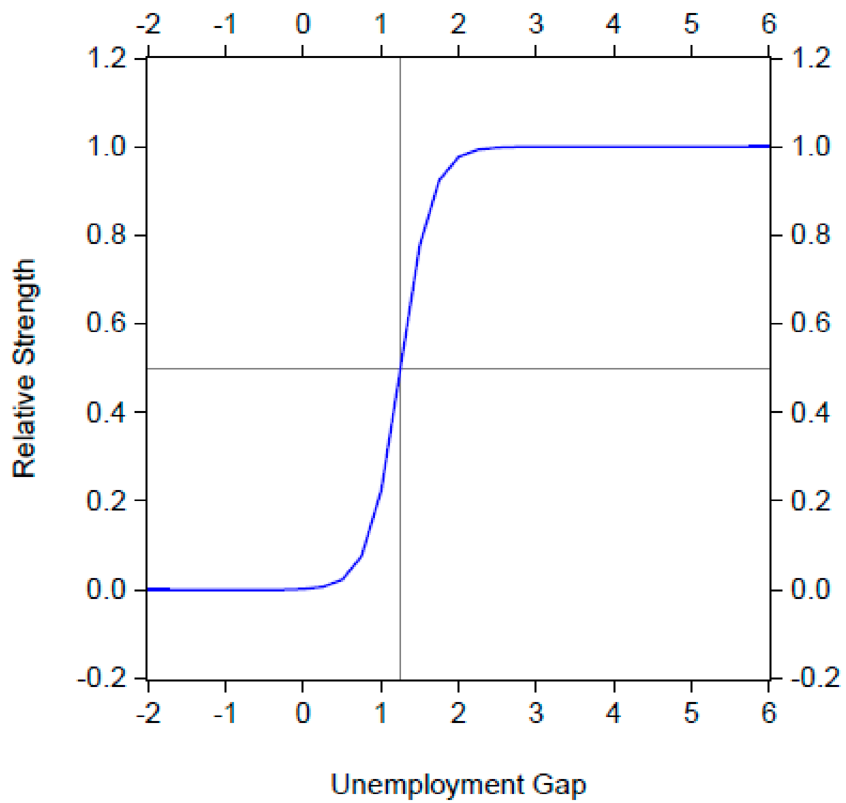
This is an annoying paper to discuss.

A few key take-aways

- Supply versus Demand Shocks: Not so clear.
- Recent events: After 2007, potential GDP growth slowed from 2.6 to 1.3 percent per year.
- Uncertainty about the natural rate of unemployment: the 95 percent confidence interval is about 4.5 to 7 percent.
- Hysteresis and optimal monetary policy: They say monetary policy should be more accommodative.

How do hysteresis effects work?

Figure 4.1
Assumed Relationship Between the Level of Slack
and the Relative Strength of Hysteresis Effects



Is this the right objective function?

$$L_{t0} = E_t \sum_{j=0}^{N} \beta^j \left\{ \alpha_1 \left(U_{t0+j} - U^*_{t0+j} \right)^2 + \alpha_2 \left(\pi_{t0+j} - 2 \right)^2 + \alpha_3 \left(\Delta R_{t0+j} \right)^2 \right\}.$$

The Bottom Line

- This paper raises key issues about hysteresis.
- But its analysis of policy builds on some questionable assumptions.
- Need more research.
- This paper is a good place to start.