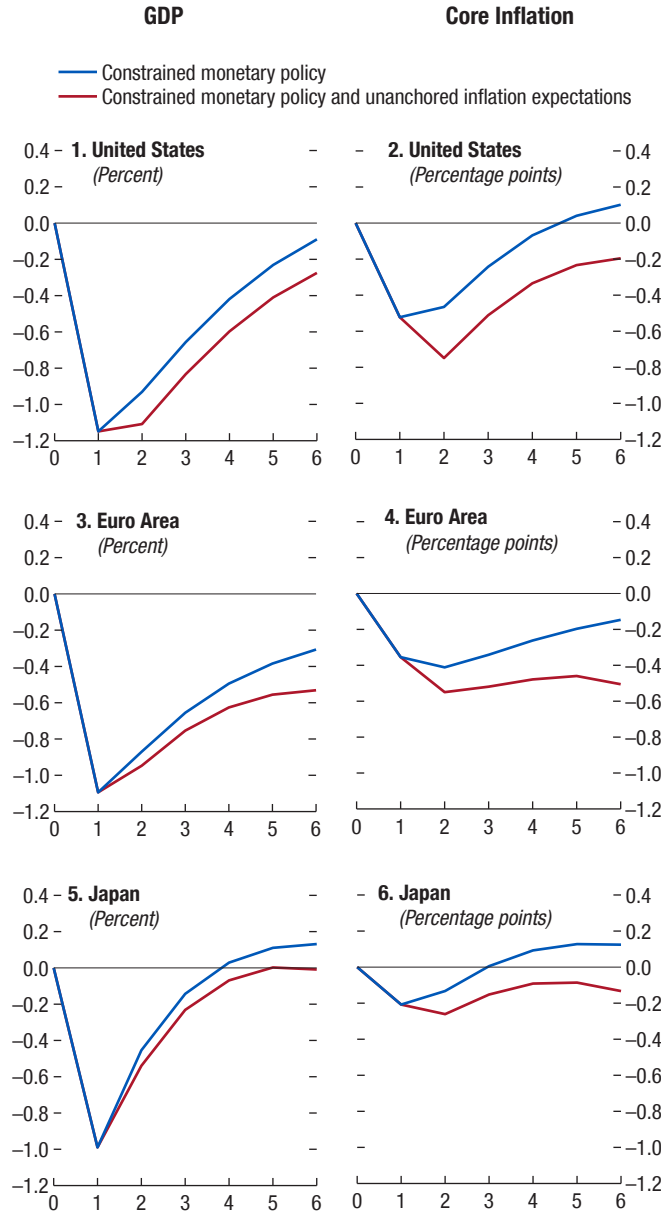


Figure 3.4. Effect of Disinflationary Shocks in Advanced Economies under Constrained Monetary Policy and Unanchored Inflation Expectations

(Years after the shock on x-axis)

Demand-driven deflationary shocks can have particularly large and persistent negative effects if monetary policy is constrained and inflation expectations become unanchored.



Source: IMF staff estimates.

Note: The figure reports the deviation of output and core inflation from their baseline path after a temporary decline in domestic demand. It is assumed that conventional monetary policy in all countries is constrained at the effective lower bound on nominal interest rates. The alternative scenario (red line) also assumes that inflation expectations are affected by inflation shocks in line with the empirical evidence presented in the chapter. See Annex 3.2 for further details.