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Quantitative Economics
Mark Weder, Aarhus University:
Do We Really Know that Monetary Policy was Destabilizing in the 1970s?

Abstract:
The paper re-examines whether the Federal Reserve’s monetary policy was a source of instability during the Great Inflation by estimating a sticky-price model with positive trend inflation, commodity price shocks and sluggish real wages. Our estimation provides empirical evidence for substantial wage-rigidity and finds that the Federal Reserve responded aggressively to inflation but negligibly to the output gap. In the presence of non-trivial real imperfections and well-identified commodity price-shocks, U.S. data prefers a determinate version of the New Keynesian model: monetary policy-induced indeterminacy and sunspots were not causes of macroeconomic instability during the pre-Volcker era.

The next EconNewsletter will be published on Monday, May 25, 2020.


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