Discussion of

“The Making of a Great Contraction with a Liquidity Trap and a Jobless Recovery”

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To exit or not to exit

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- A warning about **unemployment traps**
- And a proposal to central banks for an **exit strategy**
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The model features

- **Firms** never experience unfulfilled vacancies
- **Households/workers** suffer involuntary unemployment, because nominal wages are downward rigid
- **Fiscal authority** balances the budget each period with a lump-sum tax
- **Monetary authority** sets the nominal interest rate with a simple policy rule subject to the ZLB constraint
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Because of the ZLB constraint, the model has two distinct steady states:

1. **Full employment** steady state, with inflation at target
2. **Low employment** steady state, featuring deflation

In the first steady state monetary policy ensures that economic resources are fully utilized, while in the second steady state the economy is stuck in a liquidity trap.
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- Depending on the cause of the recession, the model can explain two types of recovery:
  1. Adverse demand shock is followed by a job creating recovery
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- To restore confidence, the central bank can just raise the nominal interest rate back to the intended target.
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Caveats about the exit strategy

- Even if expectations are fully rational, confidence in the central bank’s ability to achieve its inflation target may be easier to loose than to restore
- Overshooting the nominal interest rate target, as part of the exit strategy, may speed up the recovery
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