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The Phillips Curve and the Missing Disinflation from the Great Recession

By Willem Van Zandweghe

Although inflation has run somewhat below the Federal Reserve's 2 percent objective during the ongoing economic expansion, the "missing disinflation" during the Great Recession presents a much bigger puzzle for economists. During the recession, unemployment rose sharply, but core inflation declined only moderately. As a result, some economists have questioned whether the traditional inverse relationship between inflation and unemployment—known as the Phillips curve—still holds.

Willem Van Zandweghe estimates a Phillips curve model consistent with microdata on consumer prices. The model predicts stable inflation with a decline in unit labor costs during the recession, in line with the observed patterns in these macroeconomic variables. The model provides support for the view that inflation expectations shaped by monetary policy played an important role in preventing disinflation after the Great Recession. His results suggest Phillips curve models remain useful tools for central banks.

Capital Reallocation and Capital Investment

By David Rodziewicz and Nicholas Sly

Corporate debt levels have grown substantially during the 10-year recovery from the global financial crisis. This debt might be expected to finance investments that support firm expansion, as the U.S. economy has experienced strong growth over the last 10 years. However, much of the corporate debt has been used to reallocate capital through mergers and acquisitions rather than to fund investment activity. Perhaps as a result, some market watchers have expressed concerns that corporations are crowding out, rather than complementing, new investment.

David Rodziewicz and Nicholas Sly show that rising merger and acquisition activity does not fully crowd out new capital investment, as both sales of existing capital between firms and investment in new capital tend to rise and fall together. Moreover, they find that this relationship holds both in the aggregate and within most U.S. industries. Their results suggest that rising merger and acquisition activity complements investment growth by allowing firms to strategically position themselves and build their productive capacity.

Implementation Delays in Pension Retrenchment Reforms

By Huixin Bi, Kevin Hunt, and Sarah Zubairy

As the global population ages, public spending on pensions has increased dramatically. As a result, policymakers have increasingly focused on pension retrenchment reforms to keep their systems solvent. These reforms usually involve long implementation delays to provide retirees time to adjust their retirement plans. However, long implementation delays also slow the rollback of governments' pension spending, potentially raising long-run fiscal risks.

Huixin Bi, Kevin Hunt, and Sarah Zubairy collect a new data set that tracks implementation delays during pension retrenchment reforms for 12 countries from 1962 to 2017. They find that the average phase-in period for a pension retrenchment reform is about a decade. However, they also find that implementation delays are significantly longer for age-related pension reforms, which account for a large share of pension retrenchments since 2000.

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