



International Finance Discussion Papers: The Decline of Activist Stabilization Policy: Natural Rate Misperceptions, Learning, and Expectations

By Athanasios Orphanides, John C Williams

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****.We develop an estimated model of the U.S. economy in which agents form expectations by continually updating their beliefs regarding the behavior of the economy and monetary policy. We explore the effects of policymakers misperceptions of the natural rate of unemployment during the late 1960s and 1970s on the formation of expectations and macroeconomic outcomes. We find that the combination of monetary policy directed at tight stabilization of unemployment near its perceived natural rate and large real-time errors in estimates of the natural rate uprooted heretofore quiescent inflation expectations and destabilized the economy. Had monetary policy reacted less aggressively to perceived unemployment gaps, inflation expectations would have remained anchored and the stagflation of the 1970s would have been avoided. Indeed, we find that less activist policies would have been more effective at stabilizing *both* inflation and unemployment. We argue that policymakers, learning from the experience of the 1970s, eschewed activist policies in favor of policies that concentrated on the achievement of price stability, contributing to the subsequent improvements in macroeconomic performance of the U.S. economy.



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