From Chronic Inflation to Chronic Deflation

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Highlights
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Blind Spots:

1. Expectations driven crises
2. “Liquidity” crises
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1. Expectations driven crises
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Policy:

1. Ensure sufficient “liquid/safe assets”
2. Global coordination of policy
Expectations Crises: Draghi Put

Sovereign 10 year yields

- Greece
- Ireland
- Portugal

- Lehman Collapse
- Greek Crisis
- Draghi Put
Policy Implications
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- Aguiar, Amador, Farhi and Gopinath (2014)
  - Crisis and Commitment: Inflation Credibility and the Vulnerability to Self-fulfilling debt crisis
  - Coordination and Crises in a Monetary Union
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- Should monetary policy play an active role in debt crises? Yes

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Liquidity Crises

Unconventional Policy
- Buy toxic assets
- Increase government debt
- Forward guidance weak

Unsavory Spillovers
- Search for other “safe assets”

Caballero and Farhi (2014)
Is there still a Liquidity Crisis?
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- Stein 2013 (for the U.S)
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- Caballero and Farhi (2014): High excess returns in stock market
Is there still a liquidity crisis?

- Trend Vs Cycle
- Demographics
- Slowing productivity
Global Headwinds

China’s total debt as % of GDP

Sources: People’s Bank of China; Wind Info; The Economist

*Q3
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3. Need a globally coordinated plan for the next liquidity crisis...which may be sooner than you think.
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   • Don’t throw out the baby with the bath water.
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