Webinar

The audacity of slope: How fast a recovery?

WITH PAUL KRUGMAN
COLUMNIST, NEW YORK TIMES
PROFESSOR, CUNY

Friday, May 15, 12:30 PM ET
Pre-Registration Required

PRINCETON ECONOMICS
Markus’ intro

- Previous/future webinars
  - Jeremy Stein
  - John Cochrane

- Speakers

Fed-Treasury Credit Programs
Economics of reopening
The 3 crises

- Health crisis
  - Health
  - Gaining time

- Economy crisis
  - Supply (chains), demand (hoarding)
  - Shutdown

- Financial crisis
  - Liquidity, solvency

Shut-down → contagion → Shut-down

contagion

5/18/2020
Health and economic crisis

BE SURE TO WASH YOUR HANDS AND ALL WILL BE WELL.

COVID-19

RECESSION
Friedman “plucking model”

What if there can be bubbles building up and bursting?

Holds reasonable well for US during 1960 - 2008 but not internationally (Dupraz, Nakamura, Steinsson 2019)

- What if there can be bubbles building up and bursting?
US GDP in log scale

2008-Break in
- Level
- slope

Long-term trend

Billions of Chained 2012 Dollars

US GDP in log scale

2008 Break in
- Level
- Slope

No recession, but Reduced growth

Long-term trend

NASDAQ bubble

Housing bubble
Audacity of what slope?

- stylized

2008 Break in
  - Level
  - Slope

2020 COVID

Long-term trend

????
COVID speeds up existing trends?

- Long-term trend

- Negative or positive trends  (home-office, tele-medicine, ...)

- See Tyler Cowen’s YouTube video
Shocks and amplification

- Pre-crisis buildup

- Nature of the initial economic shock
  - Temporary vs. permanent (V, U, L-shaped)
  - Supply vs. demand (1970s)
  - Aggregate vs. idiosyncratic (finance)
  - ...

- Nature of amplification/feedback effects/spirals/non-linearities
  - Risk-on to risk-off: Flight-to-safety
  - Runs, spirals
  - Multiple equilibria
Permanent vs. temporary shock

- What’s optimal policy?
  - Blanchard’s 2 phases of crises
    - “Whatever it takes” phase
    - “Oh my god, what have we done” phase

- Optimal policy measures
  - Short-term work (Kurzarbeit)
    - Less damage since current relationship are maintained
    - Less adjustment to potentially new environment

- Uncertainty and policy measures
  - Flexibility & contingent policies (if foreseeable)
    - Jeremy Stein’s stage financing Venture Capitalist analogy
    - Extent guarantees
  - Less planning certainty for citizens
Inflation/Deflation pressures

- ... in a model with uncertain length of pandemic (with Sebastian Merkel, Jonathan Payne & Yuliy Sannikov)

Shocks: Pandemic + Recovery

- CES:

\[ c_t^l = \left[ \alpha^A_t \left( c_t^{AI} \right)^{\varepsilon-1} + \bar{\alpha} \left( c_t^{BI} \right)^{\varepsilon-1} \right]^{\varepsilon/(\varepsilon-1)} \]

- Output:

\[ y_t^{AI} = a_t^A k_t^{l}, \quad y_t^{BI} = \bar{a} k_t^{l} \]

Inflation depends on:
- length,
- redistribution,
- ...

YouTube link: VMACS channel: https://www.youtube.com/watch?v=sEVcEPxteZA
Poll 01:

1. Which recovery scenario do you think will be most likely
   a) V
   b) U
   c) L
   d) W

2. Will we return to a pre-COVID economy or will the economy be fundamentally different?
   a) Yes
   b) No
End of **MARKUS’ INTRODUCTORY REMARKS**

Now

Please ask questions in Q&A box

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**PRINCETON ECONOMICS**
The audacity of slope: How fast will we recover?

Paul Krugman
Apocalypse already

Change in employment (thousands)
Theoretical models generally don’t have intrinsic dynamics — use the two-period cheat (which is fine, up to a point).

Macroeconomic Implications of COVID-19: Can Negative Supply Shocks Cause Demand Shortages?

Veronica Guerrieri, Guido Lorenzoni, Ludwig Straub, Iván Werning

NBER Working Paper No. 26918
Issued in April 2020

NBER Program(s): Economic Fluctuations and Growth, Monetary Economics

A Model of Asset Price Spirals and Aggregate Demand Amplification of a “Covid-19” Shock

Ricardo J. Caballero and Alp Simsek*

April 22, 2020
March and April were devastating, but May seems to be flattening

Percent of workers newly unemployed since March 1, 14-day rolling average

But period 1 has already happened
Why? Safety net has contained income losses
Fed action has contained financial spillover

Rates on 30-day Commercial Paper Ease

Source: Board of Governors of the Federal Reserve System.

Notes: ABCP is asset-backed commercial paper. CP is commercial paper. The vertical bar marks the day of the facility’s inception.
History suggests two kinds of recovery, perhaps linked to cause of recession
Fast recoveries followed severe monetary tightening; slow followed slumps caused by private-sector excesses.
Slow recoveries seem to have followed periods of unsustainable spending, ending in Minsky/Wile E. Coyote moment
PS: Sluggish recovery from 2008 crisis widely predicted

Is the 2007 U.S. Sub-Prime Financial Crisis So Different? An International Historical Comparison

Carmen M. Reinhart, Kenneth S. Rogoff

*NBER Working Paper No. 13761*
*Issued in January 2008*

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The Conscience of a Liberal
PAUL KRUGMAN

JANUARY 22, 2008 11:09 AM
How does this apply to Covid-19 shock?

Hypothesis: difference in recession shapes not fundamentally about interest rates but rather about whether headwinds are externally or internally generated

If so, Covid slump more like 1979-82 than like 2007-9: economy could spring back quickly if viral threat lifted

But:

That’s a very big if

Market doesn’t seem to agree
How not to predict the course of the pandemic

To better visualize observed data, we also continually update a curve-fitting exercise to summarize COVID-19's observed trajectory. Particularly with irregular data, curve fitting can improve data visualization. As shown, IHME’s mortality curves have matched the data fairly well.
Markets predict slow recovery — but has been wrong in the past.

Source: Board of Governors of the Federal Reserve System (US)  fred.stlouisfed.org