Monetary Policy and Global Equilibria in an Economy with Capital

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Short-term interest rates in the United States have been near their lower bound since late 2008. Treasury rates out to a two-year maturity were close to zero from mid-2011 to mid-2013 and remain below 1%, and over this same period inflation has been declining. This combination of low interest rates and declining inflation has led some observers to point to the "perils of Taylor rules," for example, Bullard (2010), when a monetary policy that actively targets a positive inflation rate leads to an outcome with much lower inflation, and possibly even deflation. The possibility of equilibria with persistent deviations of inflation from the target set by the policy maker has been investigated for model economies without state variables. Quantitative representations of the U.S. economy as embodied by DSGE models include as an essential element capital accumulation. In this paper we study the possibility for persistent low inflation outcomes for a monetary model with capital.