

Why has the U.S. economy stagnated since the Great Recession? *

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Abstract

Related to the idea of secular stagnation, the path of U.S. real GDP has been much lower than would have been projected prior to the Great Recession. We investigate the extent to which this apparent stagnation is due to hysteresis effects of the Great Recession, a large and persistent negative output gap following the recession, or slower trend growth. To do so, we develop a new Markov-switching time series model that allows a given recession to either have a large permanent effect or lead to a full recovery and also accounts for possible structural breaks in trend growth. Estimates for our model suggest that the Great Recession generated a negative and persistent output gap, but no permanent effects, with the economy fully recovering to trend by 2014. Instead, the relatively low level and growth path of output that continues after the recovery appears to be driven by a reduction in trend growth that began in 2006, prior to the onset of the Great Recession. Our results about the timing of the reduction in trend growth are supported by data on aggregate consumption and final sales, while our findings in terms of the role of the Great Recession in explaining secular stagnation help to reconcile the lack of deflation in recent years.

Keywords: Secular stagnation; Great Recession; output gap; Markov switching; structural breaks

JEL classification: C22; C51; E32; E37

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