



Finance and Economics Discussion Series: Whats Happened to the Phillips Curve

By Flint Brayton

BiblioGov. Paperback. Book Condition: New. This item is printed on demand. Paperback. 42 pages. Dimensions: 9.7in. x 7.4in. x 0.1in. The simultaneous occurrence in the second half of the 1990s of low and falling price inflation and low unemployment appears to be at odds with the properties of a standard Phillips curve. We find this result in a model in which inflation depends on the unemployment rate, past inflation, and conventional measures of price supply shocks. We show that, in such a model, long lags of past inflation are preferred to short lags, and that with long lags, the NAIRU is estimated precisely but is unstable in the 1990s. Two alternative modifications to the standard Phillips curve restore stability. One replaces the unemployment rate with capacity utilization. Although this change leads to more accurate inflation predictions in the recent period, the predictive ability of the utilization rate is not superior to that of the unemployment rate for the 1955 to 1998 sample as a whole. The second, and preferred, modification augments the standard Phillips curve to include an error-correction mechanism involving the markup of prices over trend unit labor costs. With the markup relatively high through much of the 1990s, this...



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