Economic Review

The Phillips Curve and the Missing Disinflation from the Great Recession

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Expectations shaped by monetary policy kept inflation stable during the Great Recession despite disinflationary pressure from high unemployment.

Although inflation has run somewhat below the Federal Reserve's 2 percent objective during the ongoing economic expansion, the "missing disinflation" during the Great Recession presents a much bigger puzzle for economists. During the recession, unemployment rose sharply, but core inflation declined only moderately. As a result, some economists have questioned whether the traditional inverse relationship between inflation and unemployment—known as the Phillips curve—still holds.

Willem Van Zandweghe estimates a Phillips curve model consistent with microdata on consumer prices. The model predicts stable inflation with a decline in unit labor costs during the recession, in line with the observed patterns in these macroeconomic variables. The model provides support for the view that inflation expectations shaped by monetary policy played an important role in preventing disinflation after the Great Recession. His results suggest Phillips curve models remain useful tools for central banks.

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