Discussion of
“New Keynesian Dynamics in a Low Interest Rate Environment”
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Some recent studies show it is very large in New Keynesian models when the nominal interest rate is constant—notably, when the economy is stuck at the ZLB.

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When is the government spending multiplier large?

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Other studies omit resource costs of price changes, $\Delta \pi$, which are a “wedge” between output ($GNP$) and production ($Y$):

$$GNP \equiv C + I + G = Y(1 - \Delta \pi)$$

Consider the effects of an increase in $G$ at the ZLB.

This puts upward pressure on prices, and counters the deflationary pressure due to weak $C + I$. On net, $\Delta \pi$ will fall, which implies $Y$ rises less than $GNP$.

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An advantage of this approach is that it determines the expected duration of a ZLB episode endogenously.

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Deterministic simulations:

- *No uncertainty* about the future state of the economy.
- Least difficult to implement.
- See Fuhrer and Madigan (1997)

Stochastic simulations but imposing perfect foresight:

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Stochastic simulations:

- There is *uncertainty* about the future state of the economy.
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On solution methods for models with the ZLB

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