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Great Recession, Slow Recovery and Muted Fiscal Policies in the US*

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Abstract

This paper reconsiders the role of macroeconomic shocks and policies in determining the Great Recession and the subsequent recovery in the US. The Great Recession was mainly caused by a large demand shock and by the ZLB on the interest rate policy. In contrast with previous findings, the subsequent jobless recovery is explained by the ZLB effect. We estimate a fraction of Non-Ricardian households which is close to 50%, and obtain comparatively large fiscal multipliers. However we cannot detect a significant contribution of fiscal policies in stabilizing the US economy. For instance, the 2007-2009 large increase in expenditure-to-GDP ratios was apparently determined by the adverse non-policy shocks that caused the recession.

Keywords: DSGE, Limited Asset Market Participation, Bayesian Estimation, US Economy, Business Cycle, Monetary Policy, Fiscal Policy

JEL codes: C11, C13, C32, E21, E32, E37

1 Introduction

The Great Recession that began in the fourth quarter of 2007 and lasted until the last quarter of 2009 was the most severe and long-lasting in US postwar history. The ensuing slow-growth recovery and low inflation environment was heralded as a "new normal" for the years to come (Rogoff, 2009; Summers, 2013).

*The views expressed are purely those of the authors and may not in any circumstances be regarded as stating an official position of the European Commission.

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