

Discussion: Monetary Policy Under Okun's Hypothesis

Christopher G. Gibbs
University of Sydney and RBA

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Recap

Okun's Hypothesis (1973)

- “High-pressure economies” benefit young workers
- Young workers move up the job ladder into more productive jobs
 - Push workers out of the public sector and into the private sector
- May create lasting productivity increases that offset otherwise inflationary effects
Context: Post WW2, Korean War, and Vietnam War demobilisations

Alves and Violante (2026)

- “High-pressure economies” benefit low-skill workers in the presence of the **ZLB**
- Prolonged periods out of the labour force or unemployment erode individual productivity
- Lower-for-longer policies increase participation/productivity with small inflation costs
Context: Aftermath of the Global Financial Crisis and the Pandemic



Policy Prescription

Lower-for-longer (LfL) policies at the ZLB

$$\mathcal{R}_t = 2.25(\pi_t - \pi^*) + 8.00(\pi_t^{MA} - \pi^*)^- - 0.15(u_t - u^*)^+$$

- **Commitment** to an asymmetric response of monetary policy to
 - History-dependent inflation policy when below target (AIT -)
 - Run recoveries hot with non-response to unemployment below some targeted level (SR +)
- **Asymmetry:** LfL policy is based on the Fed's 2020 AIT policy and is a response to the asymmetry of the ZLB
 - Current inflation pressures still receive a high weight (arguably better aligned with Fed's 2025 review)
- **Key ideas:** Overshoot on inflation upon ZLB exit and ignore the labour market except when unemployment is high



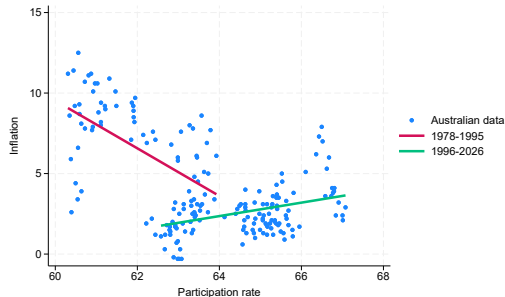
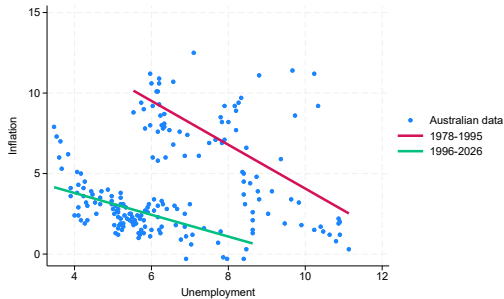
Results Summary

- There is little or **no long-run trade-off** to exploit between **inflation** and **unemployment**
- There is an inclusion or a **participation trade-off** for low-skill workers
- **High-pressure economy** pushes low-skill/young participation rates up
- Asymmetric average inflation targeting alleviates the **ZLB** constraint
- Shortfalls in unemployment response runs the economy hot in recovery

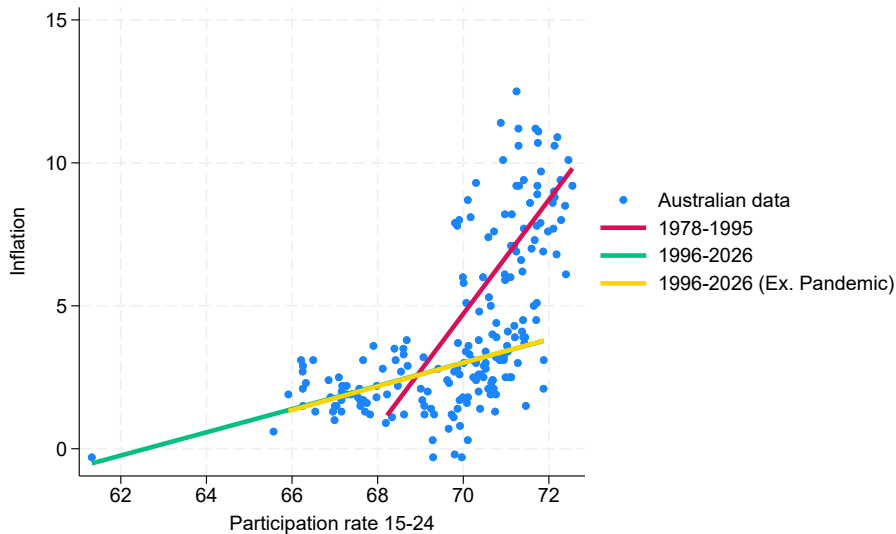
Main finding: A modest inflation overshoot following a ZLB episode can deliver lasting gains in employment, participation and earnings for low-skilled workers.



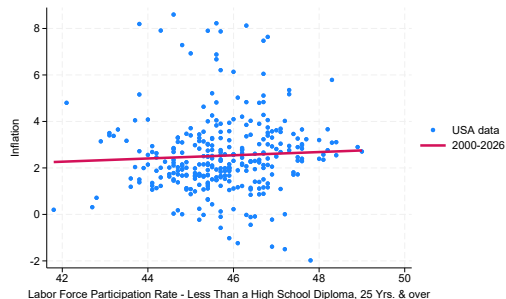
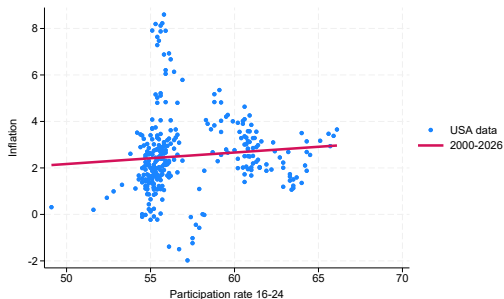
A long-run trade-off between inflation and unemployment/participation?



A long-run trade-off between inflation and youth participation?



A much weaker relationship in the USA



Additional Discussion

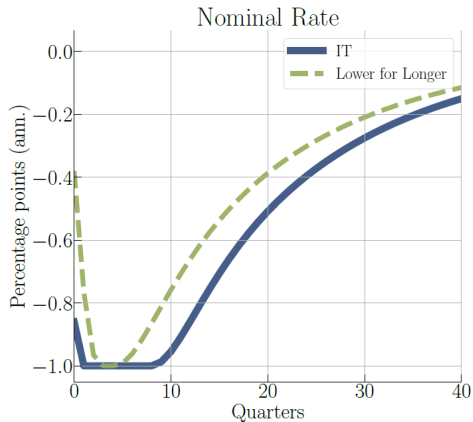
Two additional takeaways for policy:

- ① Lower-for-longer policy strategies may generate *higher* interest rates in practice
- ② Lower-for-longer policy strategies and asymmetric responses are desirable at the **ZLB** even setting aside this paper's labour-market channel

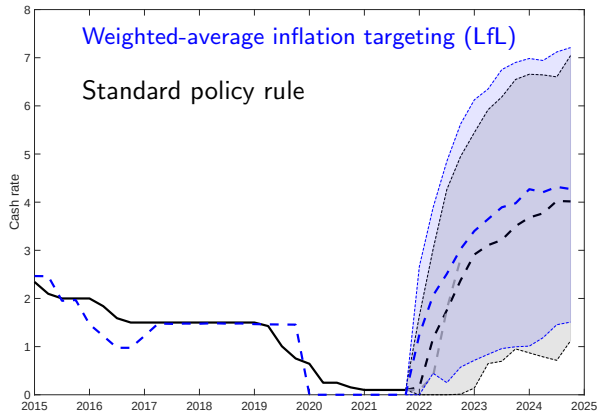


LfL can mean higher rates later

Alves and Violante (2026) - HANK



Brassil, Gibbs, and Ryan (2023) - DINGO



Aggressive policy at the ZLB is desirable

Monetary policy as insurance - Eusepi, Gibbs, and Preston (2026)

- Novel environments require people to learn about effects of shocks and policy
- Learning induces delayed and backloaded effects of policy (long and variable lags)
- Large up-front commitments to LfL required in the face of large shocks of uncertain duration to insure the economy against worst outcomes

Boundedly rational expectations and the optimality of flexible average inflation targeting - Brassil, Gibbs, and Ryan (2026)

- Expectations are central to monetary policy transmission
- Policies with LfL characteristics are robust policies across a range of expectations environments at the ZLB
- ZLB environments are “use it or lose it” situations



Conclusion

Implications for monetary policy

- **Look beyond unemployment:** participation and earnings reveal lasting costs of weak recoveries
- **Protect the recovery at the ZLB:** credible lower-for-longer policy can limit scarring while retaining a strong response to inflation
- **Judge policy by the recovery it delivers:** stronger initial support can allow higher interest rates later.

The case for aggressive policy at the ZLB is strong

