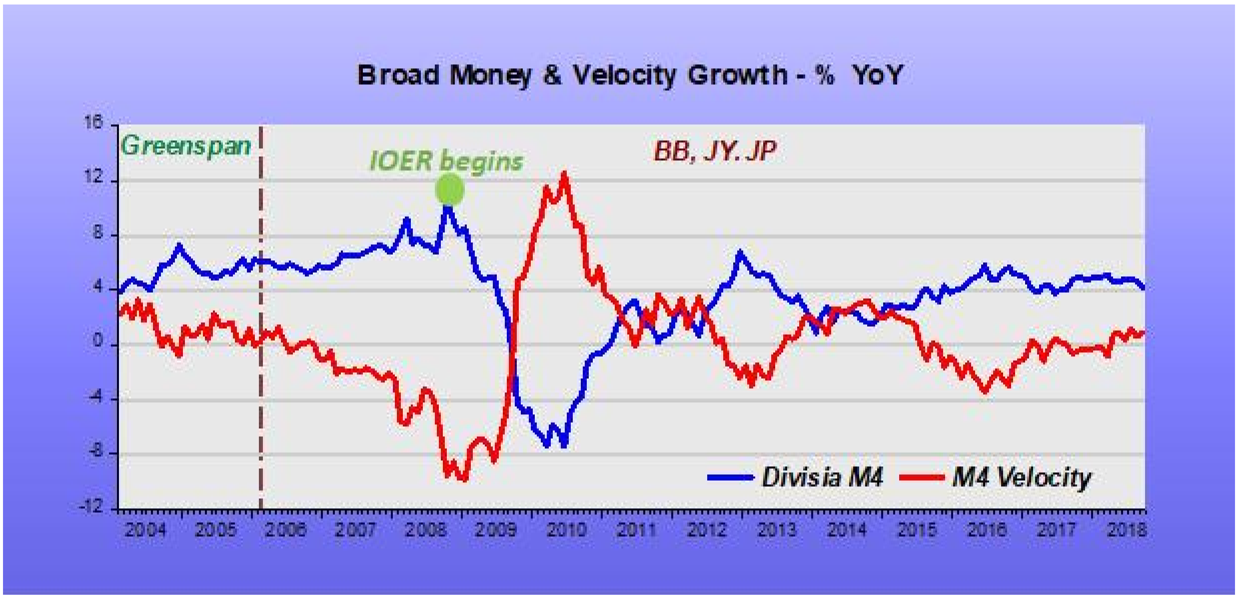
Jason Furman/Martin Sandbu have the wrong premise

> In The US´s lost decade, Martin Sandbu writes:
>
> I was recently presented with an intriguing thought experiment by Jason Furman, the chair of Barack Obama's Council of Economic Advisers. He asked me: "Assume that on September 16, 2008, you were put in charge of US fiscal and monetary policy. You are given **perfect foresight** about the slowness of the recovery and the lack of an inflationary spiral. You are allowed to use the same tools (maybe plus a little) so nothing highly exotic, but you can use them sooner, keep them on for longer, and dial them differently. If you did this:
>
> "A. What is the level of output today compared to what it actually is?
>
> "B. What is the growth rate of productivity compared to what it actually is?
>
> "C. What is the integral of output from 2009 to the present compared to what it actually has been?"
>
> It is an excellent question because it focuses the mind on how we think about the macroeconomy.

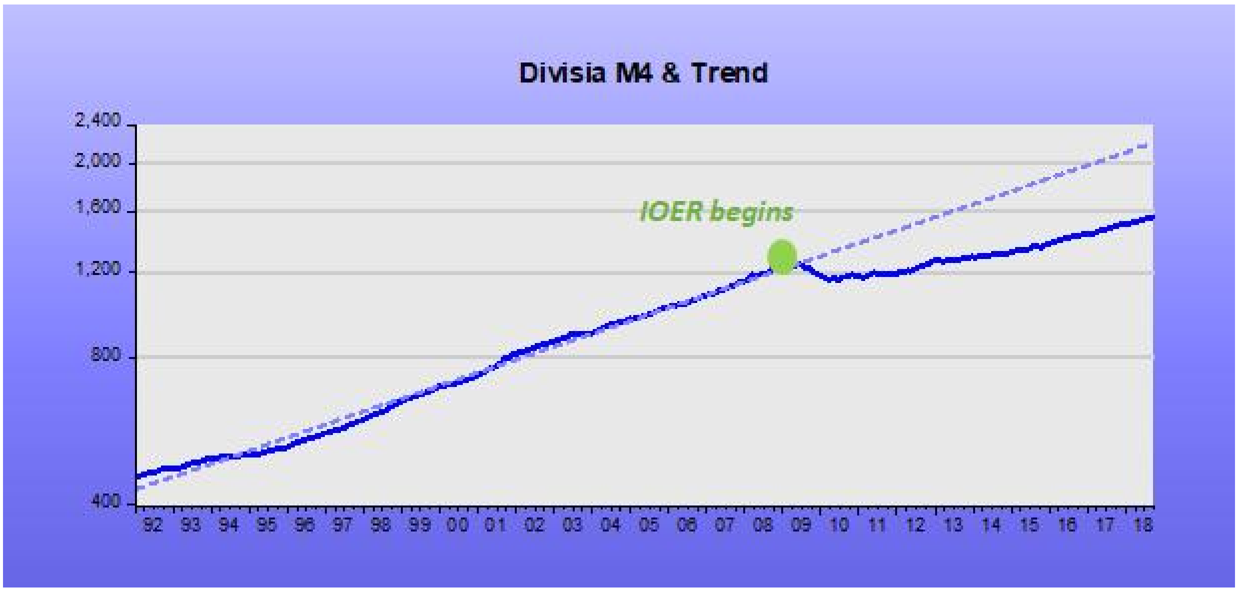
The "perfect foresight" premise is absurd because if he had perfect foresight, Sandbu would not have taken the actions that (1) led to the Great Recession and, (2) to the slowness of the recovery.

The chart illustrates and points the finger squarely at the Fed. As soon as Ben Bernanke becomes Fed chair, the fall in house prices and ensuing problems in financial (mortgage) institutions increases the demand for money (fall in velocity). Broad money supply (Divisia M4 available at the Center for Financial Stability) does not rise enough to compensate the fall in velocity (or accommodate the increase in money demand), so nominal spending (NGDP) growth falters.

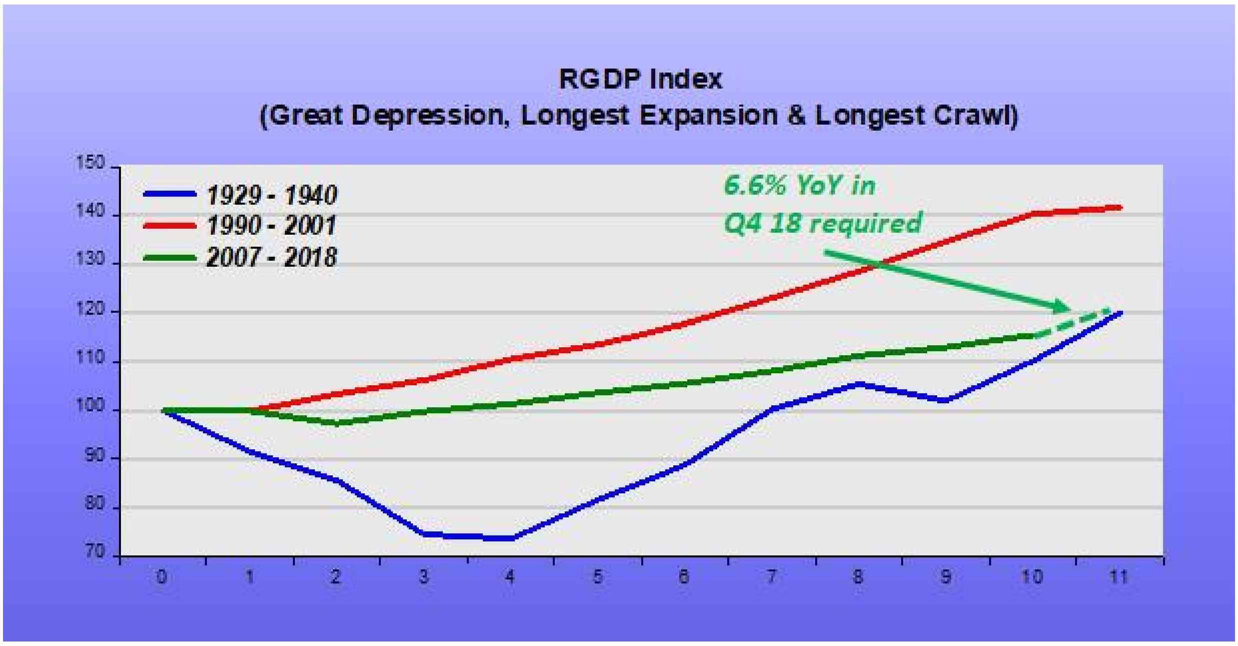
Then, the Fed took the single most destructive action it could take. It began paying interest on reserves (IOR) in October 2008, just after ending its program of sterilized lending. That was no accident, because interest on reserves was meant to be a substitute for sterilization, aimed at the same result, namely: that of making sure that the Fed’s asset purchases did ***not*** give rise to any corresponding increase in bank lending (and risk (from the Fed´s viewpoint) an increase in inflation). Broad money growth quickly turns significantly negative.



Immediately, the economy crashes, with NGDP growth falling to -4% (a first since 1937). The resulting “scarcity” of money increased velocity, pulling NGDP growth up. Broad money growth, however, although growing in a stable fashion for the past several years, has fallen far short of the trend level path and is growing at a lower rate, in fact condemning the economy to a “low & slow grind”.



The comparison of RGDP since the 2007 peak with the 1930s and the 1990s is “educational”, helping to “answer” the 3 questions posed by Furman/Sandbu.



Bottom Line: When thinking about the macroeconomy, please keep Money in the forefront of your mind.