

A Simple Theory of Deflation

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Abstract

We study a simple model that unifies the Ramsey model, Kurz's growth model with wealth effects, and Sidrauski's money-in-the-utility-function model. In a very special case, the dynamics of the model are characterized by two curves that resemble the traditional IS and LM curves. This special case has features such as deflationary spirals and a liquidity trap. Thus our model unifies neoclassical growth theory and IS-LM analysis in a simple manner.

Keywords

Neoclassical growth theory; IS-LM; deflationary spiral; liquidity trap