

Why Has the Natural Rate of Interest Declined in Recent Years?*

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Abstract

We consider multivariate trend-cycle decomposition based on a medium-scale Bayesian VAR with cointegration between real interest rates to provide a comprehensive examination of why the natural rate of interest, r^* (a.k.a. “*r-star*”), has been falling over the past few decades. An informational decomposition of the common long-run level of real interest rates suggests that uncertainty and government debt have been key determinants of movements in *r-star* since the 1970s. During the Great Moderation, the fall in *r-star* can be linked to changes in capital flows, while during the Great Recession, the substantial decline in *r-star* corresponds to increased uncertainty, a slowdown in hours worked, and an increase in the excess bond premium.

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