



## [Stagnation Traps](#)

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Can insufficient aggregate demand lead to economic stagnation, i.e. a protracted period of low growth and high unemployment? Economists have been concerned with this question at least since the Great Depression, but recently interest in this topic has re-emerged motivated by the two decades-long slump affecting Japan since the early 1990s, as well as by the slow recoveries experienced by the US and the Euro area in the aftermath of the 2008 financial crisis. This paper proposes a Keynesian growth theory in which pessimistic expectations can lead to very persistent, or even permanent, slumps characterised by unemployment and weak growth. We refer to these episodes as stagnation traps, because they consist in the joint occurrence of a liquidity and a growth trap. In a stagnation trap, the central bank is unable to restore full employment because weak growth depresses aggregate demand and pushes the interest rate against the zero lower bound, while growth is weak because low aggregate demand results in low profits, limiting firms' investment in innovation. Policies aiming at restoring growth can successfully lead the economy out of a stagnation trap, thus rationalising the notion of job creating growth.