

EC 11: ADVANCED MACROECONOMICS

Business Cycles, Nominal Rigidities, and Macroeconomic Policy

Syllabus

This course offers an introduction to some recent developments in macroeconomic theory and sets up the basic centralized dynamic general equilibrium model in a closed economy. We discuss some topics in flexible-price macroeconomic models with rational expectations, such as alternative methods for solving rational expectations models, policy effectiveness, and the role of imperfect information. Then we shift our focus to models with rational expectations that incorporate nominal rigidities in frameworks where aggregate spending is linked to the quantity theory of money. We consider the role of monopolistic competition as well as staggered wage and price setting which constitute key element of the New-Keynesian framework. We discuss some building blocks of the New-Keynesian macroeconomics and its use for policy analysis. We then consider monetary policy and discuss its use for stabilization, its effects on output and its design. Time permitting we will discuss consumption. The objective of this course is not to cover exhaustively the above topics but rather to familiarize the students with elements of the modern literature that are used in the most recent developments in macroeconomics.

Readings: A list of readings per topic is provided below. The main/compulsory readings for each topic are denoted with a star (*).

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Textbooks: We will mainly focus on Romer (4th edition) but we may use other textbooks include the following (books with a star are the most important):

Main Textbook: Romer, D., (2006), *Advanced Macroeconomics*, Third Edition, McGraw-Hill. (*)

[or Romer, D., (2001), *Advanced Macroeconomics*, Second Edition, McGraw-Hill.]

[or Romer, D., (2012), *Advanced Macroeconomics*, Fourth Edition, McGraw-Hill.]

Other textbooks:

- Benassy, J-P., (2011), *Macroeconomic Theory*, Oxford University Press.

- Blanchard, O., and S. Fisher, (1989), *Lectures on Macroeconomics*, MIT Press, Cambridge Massachusetts & London, England.
- Gali, Jordi, (2008) *Monetary Policy, Inflation, and the Business Cycle An Introduction to the New Keynesian Framework*, Princeton University Press.
- Ljungqvist, L., and T. Sargent, (2004), *Recursive Macroeconomic Theory*, MIT Press.
- Turnovsky, S., (2000), *Methods of Macroeconomic Dynamics*, Second Edition, MIT Press, Cambridge Massachusetts & London, England. (*)
- Obstfeld, M. and K. Rogoff, (1997), *Foundations of International Macroeconomics*, MIT Press, Cambridge Massachusetts & London, England.
- Walsh, C., (2003), *Monetary Theory and Policy*, Second Edition, MIT Press, Cambridge Massachusetts & London, England. (*)
- Wickens, M., (2008), *Macroeconomic Theory a Dynamic General Equilibrium Approach*, Princeton University Press. (*)
- Woodford, M., (2003), *Interest & Prices: Foundations for a Theory of Monetary Policy*, Princeton University Press, Princeton and Oxford.

Lectures Outline

Introduction and recent developments in macroeconomics

- Woofdford, M. (2009), "Convergence in Macroeconomics: Elements of the New Synthesis" *American Economic Journal: Macroeconomics*, (1), pp. 267-79. (*)
- Chari, V. V., and Patrick J. Kehoe (2006), "Modern Macroeconomics in Practice: How Theory is Shaping Policy," *Journal of Economic Perspectives*, 20 (4) (Fall): 3-28.
- Chari, V. V., and Patrick J. Kehoe (2007), "Reply to Solow," Federal Reserve Bank of Minneapolis Research Department, *Working Paper* 654.
- Mankiw, N. Gregory, (1990), "A Quick Refresher Course in Macroeconomics," *Journal of Economic Literature*, Vol. XXVIII, pp. 1645-1 660.
- Mankiw, N. Gregory, (2006), "The Macroeconomist as Scientist and Engineer," *Journal of Economic Perspectives*, Fall, 29-46.
- Pesaran, M. H. and R. P. Smith (2011), "Beyond the DSGE Straightjacket," *The Manchester School*, Vol. 79 Supplement, pp. 5-16
- Solow, Robert (2008), "The State of Macroeconomics," *Journal of Economic Perspectives*, Vol. 22, No 1, pp.243-249.

Microeconomic foundations, incomplete nominal adjustment

- Romer, D. (2012), Chapter 6, pp. 267-274 (*)
- Wickens, M., (2008), Chapter 2.
- Obstfeld, M. and K. Rogoff, (1997), Chapter 1.

Real rigidities and coordination failures

- Romer, D. (2012), Chapter 6, pp. 278-292 (*)

Stochastic Dynamic Models with Rational Expectations (solving RE models, policy effectiveness, imperfect information, etc.)

- Turnovsky, S. (2000), Chapters 3-5, pp.67-129(*)
- Romer, D. (2012), Chapter 6, pp. 292-306 (*) [or Romer, D. (2001), Ch. 6, pp. 266-279]

- Blanchard, O. and C. Kahn (1980), "The Solution of Linear Difference Models under Rational Expectations", *Econometrica*, 48, pp. 1305-1311.
- Lucas, R. E. Jr., (1972), "Expectations and the Neutrality of Money," *Journal of Economic Theory*, 4, pp. 103-124.

Elements of DSGE model; Staggered Wage & Price Setting; New-Keynesian Economics

- Romer, D. (2012), Chapter 7, pp. 312-361 (*)
- Wickens, M., (2008), Chapter 9, pp. 203-229 (*)
- Blanchard, O., and S. Fisher, (1989), Chapter 8.
- Blanchard, O. J., and N. Kiyotaki, (1987), Monopolistic Competition and the Effects of Aggregate Demand," *American Economic Review*, 77(4), Sept., pp. 647-666.
- Taylor J. (1999), "Staggered Price and Wage Setting in Macroeconomics" Chapter 15 in J. B. Taylor and M. Woodford (eds.) *Handbook of Macroeconomics*, Volume 1B, North Holland.
- Walsh, C. (2010), Chapter 8. (*)
- Gali, Jordi (2003), "New Perspectives on Monetary Policy, Inflation, and the Business Cycle," in *Advances in Economics and Econometrics*, volume III, edited by M. Dewatripont, L. Hansen, and S. Turnovsky, Cambridge University Press (also available as NBER WP #8767). (*)

Policy Analysis in the New-Keynesian/New-Neoclassical Synthesis Framework

- Clarida, R., J. Gali, and M. Gertler, (1999) "The Science of Monetary Policy: A New Keynesian Perspective," *Journal of Economic Literature*, 37 (4), pp. 1661-1707. (*)
- Schmitt-Grohé, S., and M. Uribe (2002), "Optimal Fiscal and Monetary Policy under Sticky Prices," NBER WP# 9220.
- Wickens, M., (2008), Chapter 13, pp. 348-369 (*)
- Woodford, M., (1998), "Doing Without Money: Controlling Inflation in a Post-Monetary World," *Review of Economic Dynamics*, 1, pp. 173-219.

Monetary Policy

- Romer, D. (2012), Chapter 11, pp. 513-576 (*)

Consumption

- Romer, D. (2012), Chapter 11, pp. 365-398 (*)

Some topics from the empirical literature: NK Phillips curves, Taylor rules and monetary policy effects

New Keynesian Philips Curves

- Angeloni, F., M. Ehrmann and F. Smets, (2006), "Inflation persistence and price-setting behavior in the euro area-A summary of the IPN evidence, ECB, *Occasional Paper*, 46.
- Ball, L., (1993), "How costly is disinflation? The historical evidence", *Federal Reserve Bank of Philadelphia Business Review* Nov./Dec.:17-18.
- Fuhrer, J. and G. Moore, (1995), "Inflation Persistence", *Quarterly Journal of Economics*, 110, 1, 127-159.
- Gali, J. and M. Gertler, (1999), "Inflation dynamics: A structural Econometric analysis", *Journal of Monetary Economics*, 44, 2, 195-222.

- Gali, J., M. Gertler and D. Lopez-Salido, (2001), "European inflation dynamics", *European Economic Review*, 45, 7, 1237-1270.
- Roberts, J., (2006), "Monetary policy and inflation dynamics", *International Journal of Central Banking*, 2, 3, 193-230.
- Rudd, J. and K. Whelan, (2005), "New tests of the new Keynesian Phillips Curve", *Journal of Monetary Economics*, 52, 6, 1167-1181.
- Sbordone, A., (2005), "Do expected future marginal costs drive inflation dynamics?", *Journal of Monetary Economics*, 52, 6, 1183-1197.

Monetary Policy Rules

- Woodford, M., (2003), Chapter 8, Section 3, pp. 582-610.
- Clarida, R., J. Gali, and M. Gertler, (1998), "Monetary Policy Rules In Practice: Some International Evidence," *European Economic Review*, 42, pp. 1033-67. (*)
- Clarida, R., J. Gali, and M. Gertler, (2000), "Monetary Policy Rules and Macroeconomic Stability: Evidence and Some Theory," *Quarterly Journal of Economics*, vol. 105(1), pp. 147-180. (*)
- Catelluovo, E., (2003) "Describing the Fed's Conduct with Taylor Rules: Is Interest Rate Smoothing Important?" *ECB Working Paper* No. 232.
- Orphanides, A., (2003), "Monetary Policy Rules, Macroeconomic Stability and Inflation: A View from the Trenches", *Journal of Money Credit and Banking*, forthcoming.
- Taylor, John B. (1998): "A Historical Analysis of Monetary Policy Rules," in J.B. Taylor, ed., *Monetary Policy Rules*, University of Chicago Press.
- Svensson, L. E. O., (2003), "What is Wrong with Taylor Rules? Using Judgment in Monetary Policy through Targeting Rules," *Journal of Economic Literature*, 41(2).

Effects of Monetary Policy

- Walsh, C. (2010), Chapter 1, pp. 9-31. (*)
- Bernanke, B. S., and I. Mihov (1998), "Measuring Monetary Policy," *Quarterly Journal of Economics* 113, 869-902.
- Christiano, L. J., M. Eichenbaum, and C. L. Evans (1999), "Monetary Policy Shocks: What Have We Learned and To What End?" in Taylor, John B., and Michael Woodford, eds., *Handbook of Macroeconomics*, vol. 1A, North-Holland.
- Sims, C., (1980), "Macroeconomics and Reality," *Econometrica* 48, no. 1, 1-48.
- Sims, C., (1992), "Interpreting Macroeconomic Time Series Facts: The Effects of Monetary Policy," *European Economic Review* 36, 975-1101.
- Bills and Klenow (2004), "Some Evidence on the Importance of Sticky Prices," *Journal of Political Economy* 112, no 5, 947-985.

Appendix

Papers focusing on solution methods and programs that will be useful to those who may consider pursuing research in some of the above topics are as follows:

- Uhlig, H., (1999), "A Toolkit for Analyzing Nonlinear Dynamic Stochastic Models Easily," in R. Marimon and A. Scott (eds.), *Computational Methods for the Study of Dynamic Economies*, Oxford: Oxford University Press, pp. 30-61.
- King, R. G. and M. W. Watson, (2002), "The Solution of Singular Linear Difference Systems under Rational Expectations," *International Economic Review*.
- Söderlind, P., (1999), "Solution and Estimation of RE Macromodels with Optimal Policy," *European Economic Review*, 43, pp. 813-823.