

Macroeconomics II: Intermediate Macroeconomic Theory

Minterm II (October 27, 2008 – December 19, 2008)

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Course webpage: <http://www.kse.org.ua/shepotylo/Macro2/index.htm>

Course Objective:

Macro II is an intermediate level course in Macroeconomics. It is focused on the Macroeconomics of short-term fluctuations. Emphasis of the course is on understanding and developing conceptual models to explain how the economy behaves in the short-run. Students are expected to prove mastery of these principles by developing an ability to apply them to solve a wide range of economic problems. Problem solving techniques rely heavily on algebraic and graphical methods.

This course will provide students a good theoretical background of theories of the short term macroeconomic fluctuations. First, the course introduces building blocks of the IS-LM model which include monetary and real sides of aggregate demand and supply. Second, the IS-LM model is studied and applied to real life examples of monetary and fiscal policies. Finally, the course moves to recent advances in the short run macroeconomics fluctuations. Both the New Keynesian theory and Real Business Cycle theory are analyzed using the modern mathematical models. The models are tested by using empirical evidence.

References:

Textbook

Mankiw, N. Gregory, "Macroeconomics," Fifth Edition

Additional readings

Romer, D, "Advanced macroeconomics," Chapters 4-6

Mankiw, N. Gregory, "The macroeconomist as scientist and engineer,"

<http://www.nber.org/papers/w12349>

Course Outline

Part I Introduction to the monetary economics

This first section introduces students to the monetary side of Macroeconomics. It includes the following concepts and models

- 1 Money and Inflation – we discuss functions of money, discuss the role of money and the impact of inflation on the real side of the economy
- 2 Money Supply and Money Demand – we introduce quantity theory of money, discuss alternative theories of money demand, and discuss how central bank can manage money supply.

Required readings

Mankiw (2006) “The Macroeconomist as Scientist and Engineer,” NBER Working Paper No. 12349

Chapter 4 Money and Inflation

Chapter 18 Money Supply and Money Demand

Recommended readings

Romer, Chapter 10, Sections 10.1-10.2

Part II The economy in the short run

Introduction to the macroeconomics of short-term fluctuations

This section explains the difference between the short and long runs and introduces aggregate supply and demand

- 1 Empirical evidence on short run fluctuations – we discuss the stylized facts on macroeconomic fluctuations
- 2 Short and long runs in economic theory – we analyze differences between short and long run in economics and how these difference influence our choice of appropriate economic models
- 3 Introduction to aggregate demand – we introduce the aggregate demand and study its behavior as a function of money
- 4 Introduction to aggregate supply – then, we move to the aggregate supply equation, discuss the production function and introduce the concept of natural rate of unemployment
- 5 Supply and demand shocks – we study how monetary and fiscal shocks to the aggregate demand and supply influence macroeconomic variables
- 6 Example: the 1970s Oil shock – finally, we use the case study of the 1970s oil shock to demonstrate how we can use the theory to explain the empirical regularities.

Required readings

Aggregate Demand

This part of the course studies the aggregate demand in details at more advanced level. develops the IS-LM model, the theory that yields the aggregate demand curve. It includes the following parts

- 1 IS curve – we study the *IS* curve, and its relation to the Keynesian Cross and the Loanable Funds model
- 2 LM curve – we study the *LM* curve, and its relation to the Theory of Liquidity Preference
- 3 The IS-LM model – we analyze how the *IS-LM* model determines income and the interest rate in the short run when P is fixed
- 4 Economic policy analysis – we see how policies and shocks affect income and the interest rate in the short run when prices are fixed
- 5 Aggregate demand – we derive the aggregate demand curve using the IS-LM model
- 6 The Great Depression- we explore various explanations for the Great Depression in the framework of the models developed in this chapter

Required readings

Chapter 10 Aggregate Demand I

Chapter 11 Aggregate Demand II

Recommended readings

Romer, D, “Advanced macroeconomics,” Chapter 5.1-5.2

Aggregate Supply

We study three models of aggregate supply in which output depends positively on the price level in the short run and discuss the short-run tradeoff between inflation and unemployment known as the Phillips curve

1. The sticky-wage model – aggregate supply is derived based on the assumption that wages are slow to adjust in the short run
2. The imperfect-information model – aggregate supply is derived based on the assumption that the economic agent do not have all necessary information to interpret change in prices
3. The sticky-price model – aggregate supply is derived based on the assumption that prices are slow to adjust in the short run
4. Phillips curve - we derived the Phillips curve from the short run aggregate supply curve
5. Inflation and expectations – we analyze how the prediction of our model change when we introduce adaptive and rational expectations in the Phillips curve.

6. The natural rate hypothesis and hysteresis – finally, we discuss some alternative models that explain the trade-off between the unemployment and output

Required readings

Chapter 13 Aggregate Supply

Recommended readings

Romer, D, “Advanced macroeconomics,” Chapters 5.4-5.6

Part III Advanced topics in macroeconomics

The final part of the course make students familiar with the modern modifications of the models studied in the previous part of the course. It also discusses how the acquired knowledge can be applied to stabilize aggregate output and curb the inflation

- 1 Stabilization policy – we discuss should be economic policy active or passive and should it be governed by rules or by discretion
- 2 Real business cycle theories and New Keynesian economics

Required readings

Chapter 19 Advances in Business Cycle Theory

Recommended readings

Romer, D, “Advanced macroeconomics,” Chapters 4 and 6

Lectures:

Tuesdays	room 24 (IIB)	10:30-11:50
Wednesdays	room 24 (IIB)	12:30-13:50

Office Hours:

As a general rule we can meet after classes or by email appointment. Please feel free to send me an email indicating when you would like to stop by.

Problem Sets (PS):

I will assign four problem sets during the semester. Each PS will be worth 5 points.

Problem sets should be turned in at the beginning of the lecture when it is due. Late problem sets will not be graded. It is your responsibility to ensure that problem sets turned in outside of the class reach me.

Exams:

Exam questions in this course require an ability to apply the course material to solve problems using graphical and mathematical analysis. There will be a mid-term exam and a final exam. **The final exam will be cumulative.** Each student is expected to take all exams. The exams will be based on:

- (1) Assigned material in the Textbook and the Problem Sets
- (2) Material covered in the lectures

Grading:

Your grade for the course is based on the sum of point for problem sets, a mid-term exam, and a final exam. The maximum number of points for each component is:

Mid-term 30 points
Problem Sets 20 points
Final Exam 50 points
Total 100 points

I will inform about grades on the problem sets and exams from time to time. If you believe that you have not received credit for a problem set you should talk to me immediately. I can not consider claims that you did not received credit for a problem set more than two weeks after grades are posted.

Course Attendance:

You are expected to attend classes regularly. If you are absent when an exam is given or homework is due, it will reflect negatively on your grade. Moreover, there is the KSE policy on class attendance.

Finally...

This syllabus is not meant to be exhaustive. It is just a set of guidelines to give you an idea of how we would like the course to proceed, and address some commonly asked questions. Any changes in this syllabus, if made, will be announced in class reasonably in advance.