

Introduction to Macroeconomics

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I – Useful information

Useful information

- **Lecturer:**
 - Vivaldo Mendes (vivaldo.mendes@iscte.pt)
- **Office:** Room 519 (Building II)
 - Tuesdays: 14.30–15.30h; Wednesdays: 11.00–12.00h.
- **Phone numbers:** internal (220372), external (217650518)
- **Course homepage:** with news and materials online already working
 - address: *<http://cm.de.iscte.pt/>*

Grading

- **Grading:** this process includes two alternatives:
- Option A
 - Final test (60%): The final test will be on December 2019
 - A group essay (40%): on a subject discussed in the course and using Julia or any other program of your choice
- Option B
 - Final test (100%): The final test will be on December 2019 or January 2020

Teaching approach

- **Computers:** they will be used as much as possible (**Julia**)
- **Good knowledge of mathematics:** it helps, however it is not enough
- The course is intended to be "**self-contained**"
- Mathematics that matters are **basic knowledge of:**
 - Derivatives
 - Difference equations
 - Optimization (Lagrangian)
 - Matrices

The textbook

- **No textbook:** there is no adopted textbook
- **Publicly available lecture notes:** will be provided (topic by topic)
- **Main reasons:**
 - Students save time
 - Lecture notes are "tailored" to each topic
 - Major available textbooks require a much lengthier course (not just 30 hours course)

Major graduate textbooks

Some major postgraduate macro textbooks available:

- David Romer (2012). *Advanced Macroeconomics*, 4th edition, McGraw-Hill, New York
- Michael Wickens (2012). *Macroeconomic Theory: A Dynamic General Equilibrium Approach*, 2nd Edition, Princeton University Press
- Jean-Pascal Bénassy (2011). *Macroeconomic Theory*, Oxford University Press, Oxford.
- Lars Ljungqvist and Tom Sargent (2012). *Recursive Macroeconomic Theory*, 3rd edition, MIT Press
- Stephen Williamson (2011), *Macroeconomics*, 4th Edition, Prentice Hall — *a good choice for those with little economics background*

II - A brief history of macro

The terrible importance of macroeconomics

*“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. **Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.**”*

John Maynard Keynes

The First (Old) Neoclassical Synthesis/Consensus

- **Young subject:** macroeconomics was "born" in the mid 1940's
 - **1946:** the first time the term "macroeconomics" were used in one title (vide next Fig.)
- **Keynesian ideas** dominated macroeconomics until early 1970's
- **The first Consensus:** Keynesian/Classical dichotomy
 - The economy "**is**" **Keynesian** in the short term: there is a **permanent trade-off** between inflation and unemployment that can be exploited by policy makers
 - The economy "**is**" **Classical** in the long term: no such permanent trade-off exists
- **In the late 1960's:** serious problems with the Consensus became evident: empirically and conceptually

The first time "macroeconomics" used in a title

Cowles Foundation Paper 14

Reprinted from

ECONOMETRICA, Journal of the Econometric Society, Vol. 14, No. 2, April, 1946
The University of Chicago, Chicago 37, Illinois, U.S.A.

MACROECONOMICS AND THE THEORY OF RATIONAL BEHAVIOR¹

BY LAWRENCE R. KLEIN

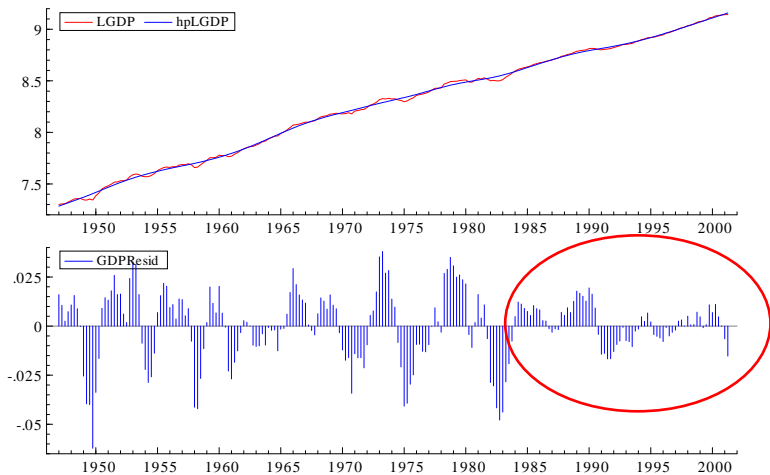
I. THE PROBLEM

MANY of the newly constructed mathematical models of economic systems, especially the business-cycle theories, are very loosely related to the behavior of individual households or firms which must form the basis of all theories of economic behavior. In these mathematical models, the demand equations for factors of production in the economy as a whole are derived from the assumption that entrepreneurs collectively attempt to maximize some aggregate profit; whereas the usually accepted assumption is that the individual firm attempts to maximize its own profit. For example Evans,² Keynes,³ Hicks,⁴ and Pigou⁵ all have in their systems marginal-productivity (i.e., profit-maximizing) equations for the total economy or for some very large subsections

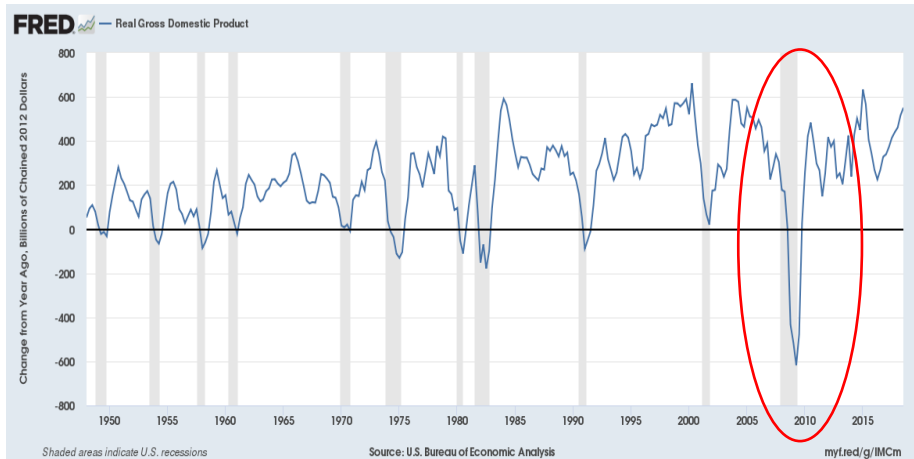
After the 1970's: revolutions and counter-revolutions

- **Sargent and Lucas:** launched the **New-Classical model** (early 1970's)
 - Macro with microeconomic foundations
- **Real Business Cycles (RBC):** problems with New-Classical model led to the RBC model in the early 1980's
 - Finn Kydland and Edward Prescott (1982), Time to Build and Aggregate Fluctuations, *Econometrica*, 50, 1345–1370)
- **New Keynesian Model:** problems with the RBC led to the development of the **NKM** (or a kind of New Consensus) in the mid 1990's:
 - Yun, T. (1996). Nominal Price Rigidity, Money Supply Endogeneity, and Business Cycles, *Journal of Monetary Economics*, 37 (April), 345–70
- **Now we have a financial crisis:** problems for the New Consensus

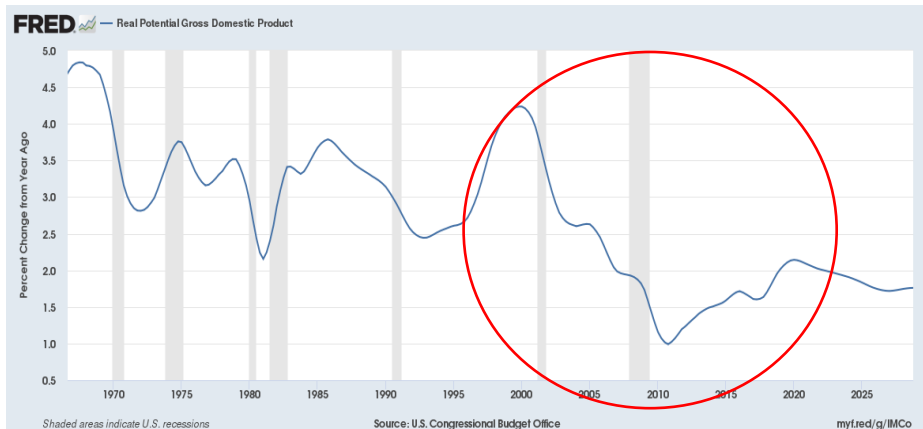
A picture of the success of the receipt (I)



Doubts about the success of the receipt (I)



Doubts about the success of the receipt (II)



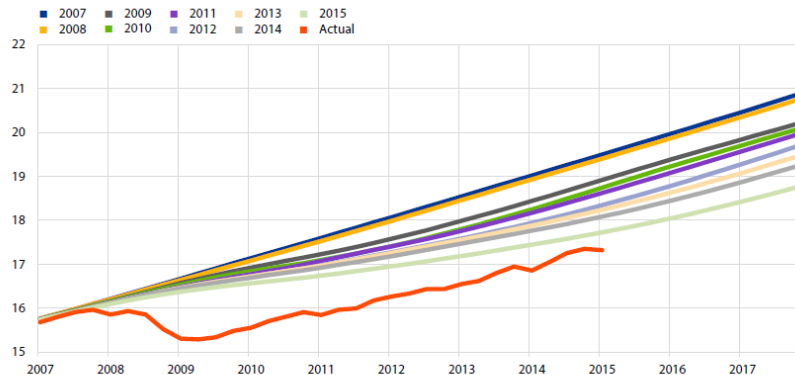
III - Major current controversies

The Unbearable Lightness of the "output Gap"

Chart 1

Actual and potential GDP

(USD trillions, at 2013 values)

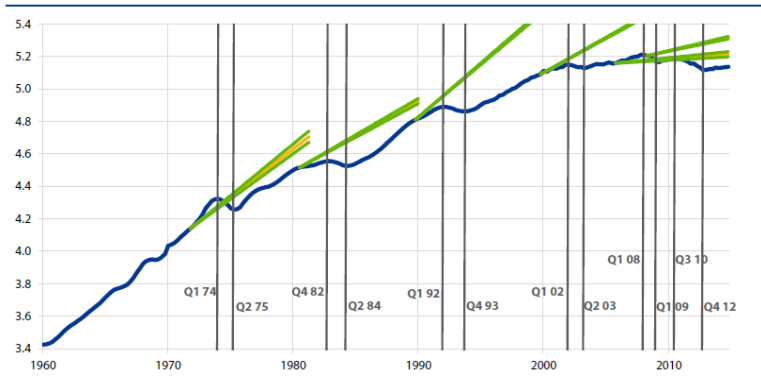


Sources: CBO Budget and Economic Outlooks 2007-2015, Bureau of Economic Analysis

After effects of recessions – hysteresis?

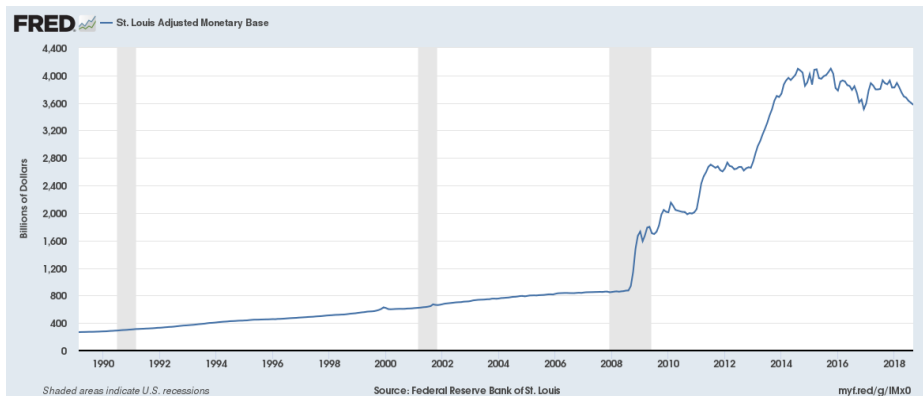
Chart 4

Evolution of log real GDP and extrapolated trends for Portugal



Olivier Blanchard, Eugenio Cerutti, and Lawrence Summers (2015). Inflation and activity - two explorations and their monetary policy implications.

The strange world of Quantitative Easing (QE)



The strange world of zero/negative interest rates



STATISTICS

PAYMENTS & CASH

MONETARY POLICY

FINANCIAL STABILITY

PRESS & PUBLISHED

ABC

REPO RATE -0.50 %

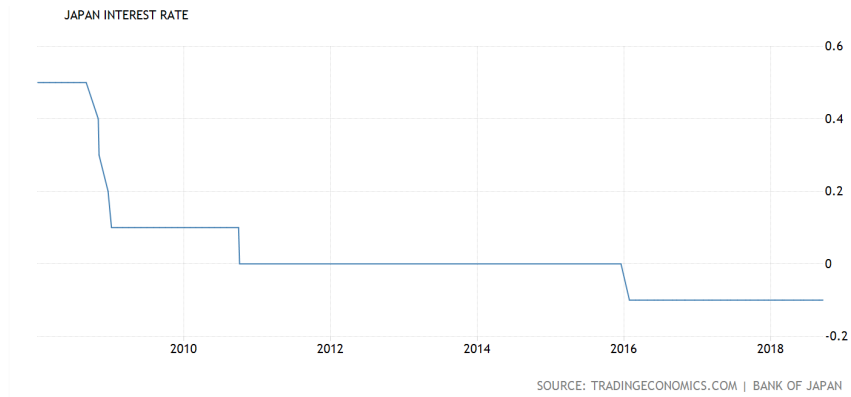
Applies from 31 October 2018

[MONETARY POLICY REPORT](#)

[CURRENT INFLATION RATE](#)

Next monetary policy announcement published on 20 December 2018

The strange world of zero/negative interest rates (cont.)



The Neo-Fisherians: the world up-side down

Neo-Fisherism

A Radical Idea, or the Most Obvious Solution to the Low-Inflation Problem?

By Stephen Williamson

“Neo-Fisherism says . . . that if the central bank wants inflation to go up, it should increase its nominal interest rate target, rather than decrease it, as conventional central banking wisdom would dictate. If the central bank wants inflation to go down, then it should decrease the nominal interest rate target.”

The fiscal multiplier: is austerity expansionary?

Wonkblog

An amazing mea culpa from the IMF's chief economist on austerity

By **Howard Schneider**

January 3, 2013

Consider it a mea culpa submerged in a deep pool of calculus and regression analysis: The International Monetary Fund's top economist today acknowledged that the fund blew its forecasts for Greece and other European economies because it did not fully understand how government austerity efforts would undermine economic growth.

The [new and highly technical paper](#) looks again at the issue of fiscal multipliers – the impact that a rise or fall in government spending or tax collection has on a country's economic output.



Problems to be explained in business cycles

- 1 Economies fluctuate over time
- 2 **Systematic facts** needed to be explained
 - 1 volatility,
 - 2 Comovements,
 - 3 Persistence (the past impacts on the present)
 - 4 How expectations affect current economic decisions

Dominant models (still dominant)

1 Dominant models

- 1 Real Business Cycles
- 2 New Keynesian Models





2 A common framework:

- 1 DSGEM
- 2 Quantitative (or computational): "simple parables" not enough anymore
- 3 Forward looking (Rational) Expectations


3 A crucial divergence about information and prices:

- 1 complete and flexible (RBC)
- 2 incomplete and sticky (NKM)

Some influential opinions

-  Olivier Blanchard (October 2018). Should We Reject the Natural Rate Hypothesis? *Journal of Economic Perspectives*, 32 (1), 97–120
-  Olivier Blanchard, Eugenio Cerutti, and Lawrence Summers (2015). Inflation and activity - two explorations and their monetary policy implications, in *ECB Forum on Central Banking*, Sintra, May 2015
-  Ricardo J. Caballero (2010). Macroeconomics after the Crisis: Time to Deal with the Pretense-of-Knowledge Syndrome, MIT, Massachusetts.
-  Willem Buiter (2009). The unfortunate uselessness of most state of the art academic monetary economics, *Maverecon* blog in the Financial Times, <http://blogs.ft.com/maverecon/2009/03/theunfortunate-uselessness-of-most-state-of-the-art-academic-monetaryeconomics/#axzz2f9d7wM1i>

Some influential opinions

 Paul Krugman, Macroeconomists at War, New York Times, August 29, 2013

http://krugman.blogs.nytimes.com/2013/08/29/macroeconomists-atwar/?_r=0

 Simon Wren-Lewis, Macro workers and macro wars, 28 August 2013

<http://mainlymacro.blogspot.pt/2013/08/macro-workers-and-macrowars.html>

 Stephen Williamson, Rottenness, December 17, 2012,

<http://newmonetarism.blogspot.co.uk/2012/12/rottenness.html>