Macroeconomic Theory II.
14.452, Spring 2002,

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This is the second course in the four-quarter graduate sequence in macroeconomics. Its purpose is to introduce the basic models macroeconomists use to study fluctuations.

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NEW: to access the problem sets, the programs and the handouts, please use FTP.
1. FTP into your Athena account: athena.dialup.mit.edu
2. Change the directory from /afs/athena.mit.edu/user/p/h/"your username" to /afs/athena.mit.edu/course/14/14.452
3. Then you see different folders. The folder NOTES contains handouts and programs. In each program folder, there is a tutorial that describes the programs. The folder PROBSETS contains the problems sets and their solutions.

It is essential that you be familiar with macroeconomics at the intermediate undergraduate level. If you have not done so yet, read an intermediate macroeconomic text (This statement is not pro forma. If you are not familiar with macroeconomics, the risk is high that you will perceive the course as a series of methods and models, not as an attempt to understand fluctuations)

There are no textbooks for the course. However, I shall use material from:
Blanchard, O. and S. Fischer, Lectures on Macroeconomics, MIT Press 1989. (BF in what follows) [covers most bases, but is aging]
Macroeconomics is a rapidly changing field. To get a sense of the geography, you might find it useful to read two recent surveys:


The course is organized around nine topics/sections. For each topic, I have included basic readings, as well as a few papers showing further applications or extensions. A star denotes required reading.

1. **Fluctuations. Facts.**

   Co-movements of GDP components. Correlations between real wages, interest rates, and output. The correlations of output and money.
   Cycles, slumps, and depressions. Non-linearities?

* BF, Chapter 1


2. The basic model. The consumption/saving choice.

Setting up the optimization problem. Intertemporal choice, shocks, uncertainty. The first order conditions.
Solving the model. Numerically. Value functions. Log linearization. Special cases and other short cuts.
Equivalence between centralized and decentralized economies. The consumption problem in the decentralized economy.

* BF, Chapters 2 and 6-2.

OR, Chapters 1 and 2

* LS, Chapters 2 and 3

* Campbell J., Inspecting the Mechanism: An Analytical Approach to the Stochastic Growth Model, JME, 33, June 1994, 463-506

3. Allowing for a labor/leisure choice. (the RBC model)


* BF, Chapter 7


Basu, S. and Fernald, J., “Why is Productivity Procyclical? Why Do We Care?,” NBER W7940, October 2000


4. Allowing for non trivial investment decisions.

Costs of adjustment for investment. Investment, consumption, and interest rates in the decentralized economy. The role of the term structure of interest rates. The stock market and investment. The effects of shocks on output, investment, the stock market, and the term structure.

The open economy version. Shocks, investment, saving, and movements in the current account.

* BF, Chapters 2-4, 6-3

Kraay, Aart, and Jaume Ventura, “Current Accounts in Debtor and Creditor Countries”, QJE, 2000-4, 1137-1166

5. Allowing for two goods.

OR, Chapter 4


6. Introducing money.


* BF, Chapter 4, sections 4.3 to 4.7; and Chapter 10, section 10.2


7. Introducing price setting.

8. Introducing staggering of price decisions.


* BF, Chapter 8-2, 8-3

* Woodford, M., Chapter 3-2 ("Optimizing Models with Nominal Rigidities. Inflation Dynamics with Staggered Price Setting.)


9. Applications to fiscal and monetary policy.

Woodford, M., Chapter 4-1, 4-2 ("A Neo-Wicksellian Framework for the Analysis of Monetary policy")


Krugman, P. “It is Baaack: Japan's Slump and the Return of the Liquidity Trap,” BPEA, 1998-2, 137-201