

University of Toronto
Department of Economics
ECO 2061H L0201
Economic Theory – Macroeconomics (MFE)
Winter 2015

Instructor	Professor George J. Georgopoulos
Office	Room 342, Max Gluskin House, 150 St. George Street
Contact	Email: georgop@chass.utoronto.ca
Lecture Hours	Tuesday 11:00 - 1:00pm, GE100; Wednesday 1-2pm, ES B149.
Tutorials	Wednesday 10-11pm, ES B149.
Office Hours	Wed 2:30-4pm, or by appointment.
Teaching Assistant	The TA is Baxter Robinson. He will be holding tutorials.

Course Description

The objective of this course is to introduce you to the study of macroeconomics at the advanced level. This means that we will use rigorous models and employ optimization techniques to present and analyze macroeconomic theories. A common theme across the models we will study is that economic aggregates are the equilibrium result of the optimizing decisions made by rational agents at the individual level. We will employ this approach, not as an end in itself, but as a means to obtain disciplined insights into the important questions that trouble macroeconomists. The topics we will cover include economic growth, business fluctuations, consumption and investment, employment and

unemployment, and fiscal and monetary policy. We will also focus on issues related to financial market frictions and their consequences to the real sector of the economy, with direct application to the most recent financial crises experienced in the United States and the Euro area.

Textbook

The recommended textbook is *Advanced Macroeconomics* (4th Edition), by David Romer, McGraw Hill, 2012.

Other References

- Obstfeld M. and K. Rogoff (1996), *Foundations of International Macroeconomics*, MIT Press.
- Pissarides, C. (2000), *Equilibrium Unemployment Theory*, MIT Press.

Evaluation

Assignments (2 in total, worth total 15%; 7.5% each):

Due Oct. 22 and Dec. 8, 2pm, 2015

Midterm Test (worth 35%): October 27, 2015, 11-1pm

Final Exam (worth 50%): December exam period

The problem sets must be handed in on the pre-specified dates.

No late submissions will be accepted. If a problem set is not handed in on time, for a justified and documented reason, the weight will shift to the final exam.

There will be no make-up exam for the midterm test. If you provide appropriate and timely documentation for missing the midterm, the weight will be transferred to the final exam.

The final exam will be held at a date and location to be set by the University. The final exam will include all the material covered in the course, with a heavier emphasis on material covered after the midterm.

List of Topics and Readings List

Topics with an asterisk (*) will be covered in class

ECONOMIC GROWTH

Stylized Facts

*Romer, Ch.1, pp.6-10.

Pritchett, Lant (1997), "Divergence, Big Time", *Journal of Economic Perspectives*, 11(3), pp.3-17.

McGrattan, Ellen and James Schmitz Jr. (1999), "Explaining Cross-Country Income Differences", *Handbook of Macroeconomics*, Vol. 1A, North-Holland. – Section 2, pp.6-10.

Jones, Charles (2002), *Introduction to Economic Growth*, (2002), 2nd Edition, W.W. Norton and Company Inc. - Chapter 1.

Growth Theory

Solow Growth Model

*Romer, Ch.1, pp.10-37.

Mankiw, Gregory, David Romer, and David Weil (1992) "A Contribution to the Empirics of Economic Growth," *Quarterly Journal of Economics*, vol. 107, pp. 407-437.

Cross - Country Income Differences

*Romer, Ch.4.1

Caselli, Francesco (2005), Accounting for Cross-Country Income Differences, *Handbook of Economic Growth*, Ch.9, Philippe Aghion and Steven Durlauf (eds.), Elsevier.

Hall, Robert E. and Charles I. Jones (1999), "Why Do Some Countries Produce so much more Output per Worker than Others?," *Quarterly Journal of Economics*, Vol.114, No.1, pp.83-116.

Acemoglu, Daron, Simon Johnson and James A. Robinson (2005), "Institutions as the Fundamental Cause of Long-Run Growth," *Handbook of Economic Growth* (Philippe Aghion and Stephen Durlauf, eds., North Holland). – Introduction.

NOMINAL RIGIDITY

****Exogenous Nominal Rigidity***

Romer, 6.1-6.4

****Microeconomic Foundations of Incomplete Nominal Adjustment***

Romer 6.9 (The Lucas Imperfect Information Model)

INFLATION AND MONETARY POLICY

*Romer, Ch.11.1, 11.2

*Central Bank's Balance Sheet and the Money Supply Process (Lecture notes)

*Reis, R., "Central Bank Design", *Journal of Economic Perspectives*, Fall 2013, Vol. 27, No. 4.

Kydland, Finn, and Edward Prescott (1977), "Rules Rather Than Discretion: The Inconsistency of Optimal Plans," *Journal of Political Economy*, 85(3), pp.473-492.

FINANCIAL MARKETS AND CREDIT MARKET IMPERFECTIONS

*Intertemporal Choice and the Investment Decision: Fisher Separation Theorem, T. Copland, F. Weston, and K. Shastri, "Financial Theory and Corporate Finance", Pearson Addison Wesley, 2005. 2005

*Intertemporal Consumption, Investment, and Social Security under credit market frictions. (Lecture Notes)

Bernanke, Ben S. and Mark Gertler. 1995. "Inside the Black Box: The Credit Channel of Monetary Policy Transmission" (in Symposia: The Monetary Transmission Mechanism), *Journal of Economic Perspectives*, Vol. 9, No. 4. (Autumn), pp. 27-48.

Bernanke, Ben, Mark Gertler, and Simon Gilchrist, 1996. "The Financial Accelerator and the Flight to Quality." *Review of Economics and Statistics* 78.1: 1-15.

Mark Gertler, "Financial Structure and Aggregate Economic Activity: An Overview", *Journal of Money, Credit and Banking* 20 (1988): 559-588

The 2007-2009 U.S. FINANCIAL CRISIS

*"The Growth of Finance", Greenwood, R., and Scharfstein, D., *Journal of Economic Perspectives*, Spring 2013, Volume 27, No.2.

*Mishkin, F., "Over the Cliff: From Subprime to the Global Financial Crisis", *Journal of Economic Perspectives*, Winter 2011, Vol. 25, No.1.

Yellen, Janet, R. "Interconnectedness and Systemic Risk: Lessons from the Financial Crisis and Policy Implications", Remarks at the American Economic Association/American Finance Association Joint Luncheon, San Diego, California, January 2013.

Christiano, Lawrence, Roberto Motto, and Massimo Rostagno (2010), "Financial Factors and Economic Fluctuations," European Central Bank Working Paper Series No. 1192.

Brunnermeier, M., "Deciphering the Liquidity and Credit Crunch 2007-2008", *Journal of Economic Perspectives*, Winter 2009.

Victoria Ivashina and David S. Scharfstein, "Bank Lending During the Financial Crisis of 2008," *Journal of Financial Economics*, September 2010. pp. 319-338.

Rajan, R.G., "Has Financial Development Made the World - Riskier?", *The Greenspan Era: Lessons for the Future*, pp. 313-69. Kansas City: Federal Reserve Bank of Kansas City, 2005

Romer, 9.1-9.3,9.9

Romer, Epilogue.

FINANCIAL STABILITY AND MACROPRUDENTIAL POLICY

*IMF (International Monetary Fund). 2013. "The Interaction of Monetary and Macroprudential Policies." Washington, D.C., January 29.

*Jenkins, P., and David Longworth. 2015. "Securing Monetary and Financial Stability: Why Canada Needs a Macroprudential Policy Framework", C.D. Howe Institute, Commentary No. 429

*Poloz, S. 2013. "Monetary Policy as Risk Management", Remarks, Canadian Club of Montreal, Montreal, Quebec, December 12.

*IMF (International Monetary Fund). 2013. "Canada: Financial Sector Stability Assessment." IMF Country Report 14/20. Washington, DC, February.

Borio, Claudio. 2014. "Monetary Policy and Financial Stability: What Role in Prevention and Recovery?" BIS Working Papers 440. Basel: Bank for International Settlements, January.

Cukierman, A. (2011), 'Reflections on the crisis and on its lessons for regulatory reform and for central bank policies', *Journal of Financial Stability* 7(1), 26 – 37.

INTERNATIONAL ECONOMICS

*The Open Economy and the Current Account, Chapter 1, *Foundations of International Macroeconomics*, Obstfeld and Rogoff, 1996, MIT Press

*Balance of Payments and Globalization (Lecture Notes)

*Ben Bernanke, "Remarks by Governor Ben S. Bernanke: The Global Saving Glut and the U.S. Current Account Deficit," March 10, 2005. Available at:
<http://www.federalreserve.gov/boarddocs/speeches/2005/20050414/default.htm>

Olivier Blanchard and Gian Maria Milesi-Ferretti, "Policy Corner: (Why) Should Current Account Balances Be Reduced?" *IMF Economic Review* (No. 1, 2012).

Maurice Obstfeld, "Does the Current Account Still Matter?" *American Economic Review* (May 2012), pp. 1-23.

FISCAL POLICY, SOVEREIGN DEBT, and the EURO CRISIS

*Thimann, C., "The Microeconomic Dimensions of the Eurozone Crisis and Why European Politics Cannot Solve Them", *Journal of Economic Perspectives*, Summer 2015, pp141-164.

*"Reassessing the Role and Modalities of Fiscal Policy in Advanced Economics", September 2013, IMF Policy Paper, <http://www.imf.org/external/np/pp/eng/2013/072113.pdf>

*Lane, P.R. (2012), "The European Sovereign Debt Crisis", *The Journal of Economic Perspectives*, Summer, pp49-68.

*"Saving Imbalances and the Euro Area Sovereign Debt Crisis", Federal Reserve Bank of New York, Volume 17, Number 5,

September 2011,
http://www.newyorkfed.org/research/current_issues/ci17-5.pdf

*Higgins, Matthew and Thomas Klitgaard, "Saving Imbalances and the Euro Area Sovereign Debt Crisis," *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, 2011,
http://www.newyorkfed.org/research/current_issues/ci17-5.pdf

Romer, Ch.12.1

Eggertsson, Gauti (2009), "What Fiscal Policy is Effective at Zero Interest Rates?" New York Fed Staff Report No. 402.

Sargent, Thomas J. (2012), "United States Then, Europe Now," Nobel Prize Lecture.

Correia, Isabel, Emmanuel Farhi, Juan Pablo Nicolini, and Pedro Teles (2011), "Unconventional Fiscal Policy at the Zero Bound," Manuscript, Harvard University.

REAL BUSINESS CYCLES THEORY

*Romer, Ch.5.

Cooley, Thomas, and Edward Prescott (1995), "Economic Growth and Business Cycles," Ch.1, in *Frontiers of Business Cycle Research*, by T.Cooley (ed), Princeton University Press.

Prescott, Edward (1986), "Theory Ahead of Business Cycle Measurement," *Federal Reserve Bank of Minneapolis Quarterly Review*, Fall, 9-22

King, Robert, and Sergio Rebelo (2000), "Resuscitating Real Business Cycles," in *Handbook of Macroeconomics*, by J.Taylor and M.Woodford, North-Holland.