

Princeton University
Woodrow Wilson School
Graduate Program

WWS 512b, Macroeconomic Analysis
(Basic)

Spring Term 2005

Tuesday, 4:15 – 5:45 pm, Robertson 001
and Wednesday, 10:40 am – 12:10 pm, Robertson 002

(Preliminary) Syllabus

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[Purpose of the Course](#), [Prerequisites](#), [Course Materials](#), [Requirements and Grading](#), [Course Outline](#)

Purpose of the Course:

This course covers the theory of modern macroeconomics in detail. We will focus on the determination of macroeconomic variables – such as output, employment, prices, and the interest rate – in the short, medium, and long run, and we will address a number of policy issues. We will discuss several examples of macroeconomic phenomena in the real world. A central theme will be to understand the powers and limitations of macroeconomic policy in stabilizing the business cycle and promoting growth.

Prerequisites:

The prerequisite is WWS 511b or equivalent. However, no previous exposure to macroeconomics is assumed. I will keep math to the minimum necessary. Students who have already taken an intermediate-level course in macroeconomics should seriously consider taking WWS 512c.

Course Materials:

The textbook for the course is [Macroeconomics](#), by Olivier Blanchard, Prentice Hall, Third Edition, 2003. The Study Guide by David Findlay is also required. Additional readings are listed in the [Course Outline](#) section of the syllabus, including links to downloadable versions when available. (THE LIST IS PRELIMINARY AND SUBJECT TO CHANGES.) These readings should also be on reserve at the Stokes Library. In addition, you should also follow current economic events by reading newspapers ([Financial Times](#), [The New York Times](#), [The Wall Street Journal](#), [The Washington Post](#)) and magazines ([Business Week](#), [The Economist](#), [Fortune](#)). Textbook and study guide can be bundled in a "value pack" including also an Interactive CD and a subscription to the online version of [The Economist](#). Alternatively, you can subscribe to The Economist at <http://www.EconomistAcademic.com>. The [IMF's World Economic Outlook](#) is a

good source of information on recent economic developments (and you can also download figures and data). Other course materials – such as my lecture notes, homework, and homework solutions – will be posted in the teaching section of my web site (<http://www2.bc.edu/~ghironi>).

Requirements and Grading:

Your grade for the course will be based on a combination of requirements:

- (Approximately) Weekly **Homework Assignments**
- A **Midterm Exam**
- A **Policy Advising Exercise**
- A **Final Exam**

Active class participation is not a formal requirement, but I encourage you to ask questions at any time during lectures.

I want you to learn how to think about macroeconomic issues and to interpret phenomena that you are exposed to in the media. **Homework Assignments** will help you to develop this ability. The harder you work on the assignments, the more likely it is that you will do well in the exams, since these will consist mostly of homework-type questions. I encourage you to form groups to discuss the homework, but each member of a group must turn in her/his own answers. Your homework answers will be graded by the Preceptor, Peter Bondarenko. Grades will be on a scale from 0 to 100. Peter will prepare homework answers that will be distributed and reviewed in precept meetings. (Precept meetings will also be occasions to discuss the additional readings mentioned in the [Course Outline](#) section of the syllabus.)

The **Midterm Exam** will take place in class, at our usual meeting time on Tuesday, March 8 (TO BE CONFIRMED). For this exam, you will be responsible for the material covered up to and including the last lecture before the exam. You should use the exercises in the textbook's Study Guide to practice for the midterm and final exams.

The **Policy Advising Exercise** will be structured as follows: You will have to form groups of four/five students. Each group will have to give a presentation of at most 20 minutes in which the group will have to provide a convincing answer to the following question: Should the Federal Reserve raise, lower, or leave the Federal Funds Rate unchanged in its next FOMC meeting? The group will have to make a case for its recommendation by using theory and data. (Useful data sources are the [Bureau of Economic Analysis](#) and the [FRED database](#) of the Federal Reserve Bank of St. Louis.) The case for the policy recommendation made by the group will be more important than the recommendation itself. All members of the group will have to speak during the presentation, which should

rely on overhead transparencies or PowerPoint. Evidence that all members of the group contributed to the project will have a positive effect on the evaluation of the exercise. The evaluation will be performed by a commission consisting of myself, Peter Bondarenko, and Princeton doctoral students in economics. You will have to pretend that the persons facing you are the Governors of the Federal Reserve, and you are the Fed economists advising them on the course of U.S. monetary policy. Your presentation will be followed by 10 minutes of questions from the "Fed Governors." All members of the group should be actively engaged in answering the questions. Groups for this exercise must be formed by March 23. We will schedule the presentations at times to be announced in late April.

All groups will be expected to give me a preliminary presentation of their material and ideas during my office hours (or at a time to be agreed upon) by April 15 at the latest. (The Fed Challenge competition is the model for this exercise.)

The **Final Exam** will take place on DATE, TIME, AND ROOM TBA. The exam will again consist of homework-type questions. It will cover material from the entire course.

The weights of the various requirements in your final grade will be as follows:

TENTATIVE:

- **Homework Assignments: 15 percent**
- **Midterm Exam: 25 percent**
- **Policy Advising Exercise: 15 percent**
- **Final Exam: 45 percent**

Course Outline:

Following is a list of the topics we will cover, along with the references to textbook and additional readings. The latter are mainly articles from the *Journal of Economic Perspectives* published after 2000 on topics or policy issues that we will mention in the course. A list of readings that you should do as you prepare for the Policy Advising Exercise is at the bottom of this section.

Part I. Introduction

- The Vocabulary of Macroeconomics, Blanchard, Chapter 2. (Read chapters 2 and 1 in advance – in that order.)
- Macroeconomics in the Real World, Blanchard, Chapter 1.

Additional Readings:

- IMF, [World Economic Outlook](#), September 2004, Chapter 1.

Part II. The Core

The Short Run

- The Goods Market, Blanchard, Chapter 3.
- Financial Markets, Blanchard, Chapter 4.
- Goods and Financial Markets: The IS-LM Model, Blanchard, Chapter 5.

Additional Readings:

- Hoshi, Takeo, and Anil K. Kashyap (2004): "Japan's Financial Crisis and Economic Stagnation," *Journal of Economic Perspectives* 18(1): 3-26.
- Ludvigson, Sydney C. (2004): "Consumer Confidence and Consumer Spending," *Journal of Economic Perspectives* 18(2): 29-50. (You can download this from the Publications section of [Sydney Ludvigson's web page](#).)
- Sellon, Gordon H. Jr. (2003): "[Monetary Policy and the Zero Bound: Policy Options When Short-Term Rates Reach Zero](#)," *Economic Review*, Federal Reserve Bank of Kansas City, Fourth Quarter, pp. 5-43.

The Medium Run

- The Labor Market, Blanchard, Chapter 6.
- Putting All Markets Together: The AS-AD Model, Blanchard, Chapter 7.
- The Natural Rate of Unemployment and the Phillips Curve, Blanchard, Chapter 8.
- Inflation, Activity, and Nominal Money Growth, Blanchard, Chapter 9.

Additional Readings:

- Ball, Laurence, and N. Gregory Mankiw (2002): "[The NAIRU in Theory and Practice](#)," *Journal of Economic Perspectives* 16 – pages. (Link: NBER Working Paper version.)
- Lucas, Robert E., Jr. (1996): "[Nobel Lecture: Monetary Neutrality](#)," *Journal of Political Economy* 104(4): 661-682. (Link: JSTOR.)
- Romer, David (2000): "[Keynesian Macroeconomics without the LM Curve](#)," *Journal of Economic Perspectives* 14(2): 149-169. (Link: JSTOR.)
- Svensson, Lars E. O. (2003): "[Escaping from a Liquidity Trap and Deflation: The Foolproof Way and Others](#)," *Journal of Economic Perspectives* 17(4): 145-166. (Link: NBER Working Paper version.)
- Taylor, John B. (2000): "[Reassessing Discretionary Fiscal Policy](#)," *Journal of Economic Perspectives* 14(3): 21-36. (Link: JSTOR.)

The Long Run

- The Facts of Growth, Blanchard, Chapter 10.
- Saving, Capital Accumulation, and Output, Blanchard, Chapter 11.
- Technological Progress and Growth, Blanchard, Chapter 12.
- Technological Progress, Wages, and Unemployment, Blanchard, Chapter 13.

Additional Readings:

- Ball, Laurence, and Robert Moffitt (2001): "[Productivity Growth and the Phillips Curve](#)," NBER Working Paper 8421.
- Mankiw, N. Gregory, David Romer, and David N. Weil (1992): "[A Contribution to the Empirics of Economic Growth](#)," *Quarterly Journal of Economics* 107(2): 407-437. (Link: JSTOR.)
- Oliner, Stephen D., and Daniel E. Sichel (2000): "[The Resurgence of Growth in the Late 1990s: Is Information Technology the Story?](#)" *Journal of Economic Perspectives* 14(4): 3-22. (Link: JSTOR.)
- Yousef, Tarik M. (2004): "Development, Growth and Policy Reform in the Middle East and North Africa since 1950," *Journal of Economic Perspectives* 18(3): 91-116.

Part III. The Role of Expectations

- Basic Tools, Blanchard, Chapter 14.
- Financial Markets and Expectations, Blanchard, Chapter 15.
- Expectations, Consumption, and Investment, Blanchard, Chapter 16.
- Expectations, Output, and Policy, Blanchard, Chapter 17.

Additional Readings:

- Browning, Martin, and Thomas F. Crossley (2001): "The Life-Cycle Model of Consumption and Saving," *Journal of Economic Perspectives* 15(3): 3-22.
- Carroll, Christopher D. (2001): "[A Theory of the Consumption Function, With and Without Liquidity Constraints](#)," *Journal of Economic Perspectives* 15(3): 3-22. (Link: NBER Working Paper version.)
- Malkiel, Burton G. (2003): "The Efficient Market Hypothesis and Its Critics," *Journal of Economic Perspectives* 17(1): 59-82.
- Modigliani, Franco (1986): "[Life Cycle, Individual Thrift, and the Wealth of Nations](#)," *American Economic Review* 76(3): 297-313. (Link: JSTOR.)
- Sargent, Thomas J. (1982): "The End of Four Big Inflations," in Robert E. Hall (ed.), *Inflation: Causes and Effects*, Chicago: University of Chicago Press. (Reprinted in Thomas J. Sargent, *Rational Expectations and Inflation*, Harper and Row.)
- Shiller, Robert J. (2003): "From Efficient Markets Theory to Behavioral Finance," *Journal of Economic Perspectives* 17(1): 83-104.

Time permitting, we will cover some material from the following parts:

Part IV. The Open Economy

- Openness in Goods and Financial Markets, Blanchard, Chapter 18.
- The Goods Market in an Open Economy, Blanchard, Chapter 19.
- Output, the Interest Rate, and the Exchange Rate, Blanchard, Chapter 20.
- Exchange Rate Regimes, Blanchard, Chapter 21.

Additional Readings:

- Calvo, Guillermo A., and Frederic S. Mishkin (2003): "[The Mirage of Exchange Rate Regimes for Emerging Market Countries](#)," *Journal of Economic Perspectives* 17(4): 99-118. (Link: NBER Working Paper version.)
- Fischer, Stanley (2001): "Distinguished Lecture on Economics in Government – Exchange Rate Regimes: Is the Bipolar View Correct?" *Journal of Economic Perspectives* 15(2): 3-24.
- Mann, Catherine L. (2002): "Perspectives on the U.S. Current Account Deficit and Sustainability," *Journal of Economic Perspectives* 16(3): 131-152.
- Obstfeld, Maurice, and Kenneth Rogoff (2004): "[The Unsustainable U.S. Current Account Position Revisited](#)," NBER Working Paper 10869.

Part V. Policy

- Should Policy Makers Be Restrained? Blanchard, Chapter 24.
- Monetary Policy, Blanchard, Chapter 25.
- Fiscal Policy, Blanchard, Chapter 26.

Additional Readings:

- Barro, Robert J., and David B. Gordon (1983): "[A Positive Theory of Monetary Policy in a Natural-Rate Model](#)," *Journal of Political Economy* 91(4): 589-610. (Link: JSTOR.)
- Kydland, Finn E., and Edward C. Prescott (1977): "[Rules Rather than Discretion: The Inconsistency of Optimal Plans](#)," *Journal of Political Economy* 85(3): 473-491 (link: JSTOR).

Readings for the Policy Advising Exercise

- Ball, Laurence, and Niamh Sheridan (2003): "[Does Inflation Targeting Matter?](#)" NBER Working Paper 9577.
- Ball, Laurence, and Robert Tchaidze (2002): "[The Fed and the New Economy](#)," NBER Working Paper 8785.
- Blinder, Alan S. (2000): *Central Banking in Theory and Practice*, Cambridge: MIT Press.
- Friedman, Benjamin M. (2004): "Why the Federal Reserve Should Not Adopt Inflation Targeting," *International Finance* 7(1): 129:136.

- Friedman, Milton (1968): "[The Role of Monetary Policy](#)," *American Economic Review* 58(1): 1-17. (Link: [JSTOR](#).)
- King, Mervyn (1999): "[Challenges for Monetary Policy: New and Old](#)," in *New Challenges for Monetary Policy*, proceedings of a symposium organized by the Federal Reserve Bank of Kansas City.
- Mishkin, Frederic S. (2002): "The [Role of Output Stabilization in the Conduct of Monetary Policy](#)," NBER Working Paper 9291.
- Mishkin, Frederic S. (2004): "Why the Federal Reserve Should Adopt Inflation Targeting," *International Finance* 7(1): 117-127.
- Taylor, John B. (1993): "[Discretion vs. Policy Rules in Practice](#)," *Carnegie-Rochester Conference Series on Public Policy* 39: 195-214.