Macro 3 : Evi Pappa

Monetary Macro: Money, Business Cycles and Economic Policy

Main References

- **Jordi Galí** (2008): *Monetary Policy, Inflation and the Business Cycle* (Princeton University Press)
- **Carl Walsh** (2003): *Monetary Theory and Policy* (The MIT Press)

Introduce Money to Study:
a) What are the main themes?

- How does monetary policy affect macroeconomic aggregates? i.e., how can a central bank affect, e.g., output, employment, consumption and inflation?
- What characterizes "good" monetary policymaking? i.e., what should the central bank aim to accomplish? i.e., which are the appropriate monetary policy regimes?
- Questions are addressed within a variety of theoretical models – Although mainly a theoretical course, empirical relevance of theories is not neglected!

b) The covered subjects:
Subject 1: Introduction and Does monetary policy matter for output and prices?
What are the stylized facts on the relationship between monetary policy and macroeconomic aggregates in the short and long run?
What are the basic empirical problems in assessing this question?
Can empirical evidence (on, e.g., the effect of money on output) be readily used for policy guidance?

Subject 2: Moneys role in flexible-price general equilibrium models
What are the effects of money in micro-founded (private-sector optimal behavior) models with flexible prices?
Do the effects match the (in particular, long-run) stylized facts?
Benchmark dynamic models and solution techniques (optimization with dynamic programming, linearization around steady state; simulations)
Basically, Ramsey models with money introduced
Examples:

- Models with money in the utility function
- Models with cash-in-advance constraints

Subject 3: Moneys role with incomplete nominal adjustment
What if prices and wages do not adjust instantaneously?
–e.g., due to informational problems (Lucas famous misperceptions model)
–e.g., due to contractually fixed prices or wages
Are the effects of monetary policy then more prominent and in accordance with the stylized facts (in particular, in the short and medium run)?

Subject 4: Credibility problems in monetary policy
Strategic issues in monetary policymaking: Importance of private sector expectations
Should monetary policy follow a fixed rule, or follow a discretionary pattern (i.e., continuously reconsider policy)?
Which type of policymaking is credible?
How can potential credibility problems e.g., leading to excessive inflation, be overcome?
Is, e.g., a politically independent central bank desirable?
i.e., focus on how monetary institutional framework (legislation) matters

Subject 5: Operating Procedures, Interest Rates and Monetary Policy
How is monetary policy conducted in the real world?

i.e., how is policy implemented? What are the operating procedures?
What can/does the central bank control; what can/does it not control?
What are central banks using as the monetary policy instrument?

Interest rates or the money supply?
Example of interest rate policy rules in small simulation model
Application: Inflation targeting

Subject 6: Monetary policy conduct in New Keynesian settings
Newest branch of models for monetary policy analysis
Dynamic, micro-founded models with sticky prices
Suitable for characterization of optimal monetary policy
Credibility problems in stabilization policy: Can they be alleviated? And through which monetary policy strategy(ies)?
The issue of proper institutional framework revisited

Subject 7: Open-economy Aspects and Monetary Policy Coordination
Monetary policymaking in open economies: the exchange rate channel
Multi-country models with macroeconomic interdependencies
What are the spill-overs of unilateral policymaking?
Is internationally coordinated monetary policy desirable, and what characterizes it?